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ABSTRACT

This issue of an annual journal contains 18 essays on unemployment insurance (UI) and employment and training programs. Part 1, "Historical Perspective," contains the following papers: "Reflections on Wisconsin and Unemployment Insurance" (Wilbur J. Cohen); "Outstanding Ideas Form UI's Foundation" (Richard Wagner); "One State's Experience: 1939" (Joseph Bildy); "Technology and the UI System" (Charlie Ballard); and "Unemployment Insurance: The System" (William U. Norwood, Jr.). In part 2, "Financing the System--Benefits and Administration," the following papers are found: "Fifty Years of State Financial Responsibility" (Joseph M. Becker); "Monetary, Nonmonetary and Benefit Formulae" (Gerry Gilmore); "The Financing Foundation of UI" (James W. Jackson); and "Financing the Administration of the UI Program" (Gerald E. Dunn, Kathleen Griffin). Part 3 "Operating the System and Economic Impact," contains the following papers: "Interstate UI through Internet" (Jane Lowry Waid); "Computerization" (Jim Coate); "Labor Market Information and UI Operations" (Steve Goodman); "The Employment Service-Unemployment Insurance Relationship" (Charles H. Davis); "UI's Effect on the Local Economy" (W. E. Parsons); and "A Divergent Paradox" (John Stine). The final part, "The Future," contains three papers: "Alternative Uses of UI Benefits" (Garth L. Mangum, Stephen L. Mangum); "Incentives, Productivity Keys to Future" (Clinton E. Petty); and "Future Directions and Changes in the UI System" (James A. Ware). (KC)

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PERSPECTIVE

Essays and reviews of issues in Employment Security and employment and training programs

UNEMPLOYMENT INSURANCE

maintaining the foundation of economic security

CE 056 715

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Vol. 1 1985

Perspective: essays and reviews of issues in Employment Security and employment and training programs, is published by the International Association of Personnel in Employment Security. The subjects covered in the text are intended to fulfill two of the time honored objectives of the association: To enhance the individual competence, knowledge and professionalism of members engaged in occupations in the field of Employment Security; and to provide a forum for the exchange of information on Employment Security and its related problems.

The International Association of Personnel in Employment Security is a nonprofit professional association representing individuals employed in the Employment Security programs of Job Service, Unemployment Insurance and Labor Market Information in federal and state governments and with nonprofit organizations. Membership is open to anyone working in or interested in Employment Security or employment and training programs. Members reside and work in more than 20 nations. The association sponsors a full range of scholarship programs, communication vehicles and membership benefit programs.

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Preface

"Few consider how much we are indebted to government, because few can represent how wretched mankind would be without it."

— Joseph Addison

"In many things a comprehensive survey of a subject is the shortest way of getting a precise knowledge of a particular division of it."

— Charles Hodge

This initial *Perspective: essays and reviews of issues in Employment Security and employment and training programs*, is a festschrift on Unemployment Insurance. The volume title, *Unemployment Insurance: maintaining the foundation of economic security*, is the winning design of Cindy Kurtz of Texas, one of 244 entries in a national contest to pick a new Unemployment Insurance logo. In 1985 the Unemployment Insurance System celebrates 50 years of quality service.

As the authors of the following essays and reviews establish, it truly has been a program that has ensured the American dream for five decades. It is fitting that the first in a series of books to be published by the International Association of Personnel in Employment Security be devoted to this singular income maintenance program. The Unemployment Insurance program is the epitome of Addison's quote, for it has been much maligned, yet would not recessions likely have become depressions without it?

The association acknowledges the guidance and leadership provided by 1984-85 president Ronald Allen Barkett, under whose administration the idea was conceived, and 1985-86 president Harry P. McKeown, under whose administration the project was completed. Shirley Reynolds and Maryann Polaski are to be thanked for their efforts to provide coordination among the authors and subjects. W. Scott Boyd, association executive director from 1962-1981, provided editorial assistance and suggested the title for the series. Finally, the association thanks all the employees of the Unemployment Insurance System whose dedication to the program has been its hallmark for 50 years, and who, in reality, made such a survey of the program possible.

Michael R. Stone
Editor

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Part I: Historical perspective

Reflections on Wisconsin Unemployment Insurance

by Wilbur J. Cohen

In 1930-1931 I was an undergraduate student at the University of Wisconsin in the last of four classes at the Alexander Meiklejohn Experimental College, an innovative and separately organized unit of the College of Letters and Sciences. One of the "advisors" in the Experimental College was Paul Raushenbush. He had completed his undergraduate work at Amherst College in 1923.

Paul had come to Madison to pursue an advanced degree in economics. Elizabeth Brandeis had been working in Washington, DC, for the District of Columbia minimum wage board. She came out to Wisconsin in the summer of 1923 and took a law course. Paul took the same law course and that is where they met. As a result an American version of Sidney and Beatrice Webb was forged that had an important bearing on the future of American social insurance and labor legislation.

I did not know of Paul's participatory role in Unemployment Compensation in 1931 until he took several Meiklejohn Experimental College students up to the capitol in December, 1931, where we watched the assembly pass the Wisconsin Unemployment Compensation bill. I still remember that historic occasion. Little did I realize then that a close relationship with Unemployment Compensation would continue for me for over 50 years.

I graduated from the University of Wisconsin in economics in June, 1934, and went to Washington, DC, at Prof. Selig Perlman's and Mrs. Florence Witte's insistence to

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Wilbur J. Cohen is professor of public affairs at the University of Texas at Austin, Lyndon B. Johnson School of Public Affairs. He was chair of the National Commission of Unemployment Compensation.

work for Prof. Edwin E. Witte. He had been named the executive director of the President's Cabinet Committee on Economic Security on Mr. Altmeyer's and Miss Perkins' recommendations. Later I became the first employee of the Social Security Board in August, 1935, as the assistant to Arthur J. Altmeyer one of the three members of the board, and later its chair, during 1935-53. Altmeyer and Witte both played a significant role in the development of the Wisconsin law of 1932 and the federal law of 1935, as did Merrill G. Murray and several other students of Prof. Commons.

The Wisconsin Law of 1932[1]

The Wisconsin plan, bill and law, was the conceptual and intellectual brainchild of Prof. John R. Commons of the University of Wisconsin economics department. Paul Raushenbush, Elizabeth Brandeis and Harold M. Groves, were the sculptors of this creative social legislation. Professor Commons was able to utilize the services of one of his students and colleagues, Prof. Harold M. Groves, a state assemblyman in the legislature, to introduce the bill. Governor Philip LaFollette recommended its passage and affixed his signature to it on Jan. 28, 1932.

It is fitting that we commemorate both the creation of the LaFollette Institute and the Wisconsin Unemployment Compensation Law. Contributions to the law were first payable on July 1, 1934, and compensable weeks for benefits began two years later on July 1, 1936. Wisconsin was the first state to pay unemployment benefits beginning on Aug. 17, 1936. The first state Unemployment Compensation bill was introduced in Massachusetts in 1916. Thus it was just 20 years from introduction of the idea in legislative form in the United States to concrete realization.

The United States, via the Wisconsin law, became the 18th nation to adopt some form of Unemployment Insurance. France is generally credited with being the first country to do so. But a big impact on the United States was when Great Britain enacted its Unemployment Insurance law in 1911 (the fifth country to do so) although there was to be a 21 year gap before the Wisconsin law was enacted.

The 1931 Groves Bill

The 1931 bill incorporated a distinctive and significant economic and political principle in the proposed legislation that was to have a far reaching impact on all Unemployment Insurance legislation in the United States and on the Social Security program of old age insurance as well. It embodied the principle of payment of benefits as a percentage of wages thus instituting a relative wage-loss concept instead of the flat uniform benefit amount in the British system and in previous United States proposals. While this principle was trasmitted from workers' accident compensation, until Paul Raushenbush suggested its inclusion in the Wisconsin Unemployment Compensation bill, it had not been a factor in the previous 15 years since the first such bill was introduced in Massachusetts in 1916.

It is most appropriate here to let Paul Raushenbush tell the historic event himself:[2]

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[1] *The historical and factual information in this paper was taken from Daniel Nelson,* Unemployment Insurance: The American Experience, 1915-1935, *University of Wisconsin Press, 1969, Chapter 6, "Wisconsin and the Commons School," pp. 104-128, and from Paul A. Raushenbush and Elizabeth Brandeis Raushenbush* Out "U.C." Story, 1930-1967, *Madison, 1979, (typewritten).*

[2] *Raushenbush and Raushenbush, pp. 52-55.*

"As to the new type of Unemployment Compensation legislation proposed early in the 1931 session, let me be a litte more specific about its background. In June of 1930, Elizabeth Brandeis and I, and Harold Groves were invited to the home of Philip LaFollette, whom Elizabeth and I knew personally.

"On this 1930 occasion, Phil LaFollette was the district attorney of Dane County. He invited us to his home one evening to make a rather startling announcement, I thought . . . He said substantially this: 'I plan to run for governor this fall and I expect to be elected; and I will want a program in the field of unemployment compensation, but I'm not sure I want the Huber Bill and its successors. I would like you three young economists to be thinking about a possible new plan. I want something that will put major emphasis on prevention and regularization. See what you can do.'

"In the ensuing weeks, I remember one occasion when we three young economists took a long weekend hike, out by the Wisconsin River, in territory we hadn't walked previously . . . During that hike — and this is the way Harold Groves recalls it, too, we spent a good deal of time talking, in a preliminary way, about the Unemployment Compensation problem and what approaches we might use.

"During that 1930 summer hike the three of us agreed . . . that each Unemployment Compensation claimant's weekly benefit should be based on his own weekly wages, instead of being a fixed flat uniform amount as in some European countries. We figured this could be more in line with American individualism, and the 'earned rights' approach of unemployment compensation legislation . . .

"We planned to peg each claimant's weekly benefit at roughly half of his own weekly wages — considering 50 percent as the percentage most readily acceptable by workers and by legislators, always subject to a weekly maximum, of course . . . As a weekly maximum we choose $10. That sounds unduly low; but the average weekly wage of Wisconsin factory workers as under $20 in 1931.

"We spent almost no time on another major feature of any U.C. bill, namely contributions by employers only. Wisconsin's position on that issue had been clear cut for a decade."

Commons and Witte experiences

In 1933-34 I enrolled in an economic course on Institutional Economics with Prof. John R. Commons. I had a difficult time following his efforts to integrate economics, law and ethics, but I became a "Friday nighter," a term which became recognized as a member of the world of Commons' students.[1] In the next semester I enrolled in a seminar on Wisconsin economic problems with Prof. Edwin E. Witte. I was exposed to the arguments, controversy and objectives, of the proponents and opponents of Unemployment Insurance. These matters not only became highly controversial and emotional in the economics department of the Unversity, but among many academic economists, in Congress, and among business and labor.

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*[1]For Commons unique ability as a teacher and policy innovator see Raushenbush and Raushenbush, pp. 4-10. See also John R. Commons, **Myself**, MacMillan, 1934. The term "Friday Nighter" originated from participating in discussions at Commons' home on Friday nights.*

The basic concept of varying the employer's contribution rate in relation to his unemployment experience was John Commons' idea derived from workers' accident compensation. Commons and many of his students and colleagues accepted this idea as an incentive and reward for prevention and reduction of unemployment. One notable exception in the UW economics department was Prof. Walter Morton who virgorously contested the theory.[4] Thus there was no peace at home or abroad on the idea.

The argument spread to other states and eventually across the nation. It was not long before the conflict shifted to Washington in 1934-35 where the pooled fund quickly overwhelmed the reserve account philosophy of Commons-Groves and Gov. Phil LaFollette. The "experience rating" principle derived from Commons workers' compensation experience was deemed more important to employers and the program. In effect, Bob LaFollette's role in preserving experience rating became a more important factor than Phil LaFollette role in initiating the reserve account, although Phil enthusiastically accepted experience rating as well. Eventually every state adopted the experience rating principle during the enactment of other state laws during 1935-39 and is solidly incorporated today in the America Unemployment Insurance system.

Wisconsin personalities

Besides Commons and Groves, Paul Raushenbush and Elizabeth Brandeis Raushenbush, John and Irene Andrews, William Leiserson, Alvin Harvey Hansen, Murray, Altmeyer and Witte, several other Wisconsinites became influential in the national ideological confliction on Unemployment Insurance. This paper does not discuss the key roles of Arthur J. Altmeyer, Merrill G. Murray over many years or of John B. Andrews. Nor does it include a discussion of the role of Wisconsin labor leaders like Jac Friedrich. Four who should be mentioned became particularly influential: Stanly Rector, the key national organizer for employers' views of Unemployment Insurance as the staff director of the Unemployment Benefits Advisors in Washington DC; Robert W. Leach, who created an organization in Wisconsin that subsequently became the national information and lobbying agency for employers opposing "federal domination" and defending experience rating — UBA; Russell Hibbard, who became the Unemployment Insurance advisor for General Motors; and Prof. William Haber, author of the important Michigan law, the chair of state and federal advisory councils, and the coauthor, with Merrill G. Murray, of the leading text on Unemployment Insurance.

My own contribution in the early years (1935-37) was related to analyzing the Canadian and other foreign laws, assistance in the drafting of the District of Columbia and North Carolina laws and interpretation of the model state bills, and then later the legislative evolution of the important 1939 amendments to the federal law.

To shift to the national scene we must recall how the pervasive influence of John Commons and Paul Raushenbush occured. Two developments put the Wisconsin actors in a crucial role.

The first was the fact that Paul Raushenbush's wife, Elizabeth Brandeis, was the daughter of Justice Brandeis of the U.S. Supreme Court. It was Justice Brandeis who

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[4] *Professor Morton's attack on the Wisconsin proposal was contained in the* American Economic Review *for September, 1933, pp. 394-412, entitled "The Aims of Unemployment Insurance with Especial Reference to the Wisconsin Act." Professors Groves and Brandeis replied to his criticism in the March, 1934, issue, pp. 48-52 in an article entitled "Economic Basis of the Wisconsin Unemployment Reserves Act."*

suggested the federal "credit offset" tax as an ingenious device to encourage by federal law the enactment of state Unemployment Compensation laws. Elizabeth played a more significant role than she is usually credited.[3]

Paul Raushenbush played an important role in the drafting (along with Tom Eliot, the associate solicitor of the U.S. Labor Department) of the federal Wagner-Lewis bill in 1934. Paul also drafted Sen. LaFollette's key amendment in the Senate to the House-passed Social Security bill in 1935, which authorized experience rating.[4]

The LaFollette contribution

Let me turn for a moment to the LaFollette family contribution to Unemployment Insurance. Phil's political and historical contribution was as governor to propose on his initiative and then to recommend passage of the Wisconsin plan to the special session of the Legislature he called on Nov. 24, 1931.[5] Then when he signed the bill into law at the end of January, 1932 — some three months later — he invited the Raushenbushes, Commons, Groves and several others to the ceremony.

Phil justified the reserve account system incorporated in the Wisconsin plan in his autobiography.[6]

Senator Robert M. LaFollette, Jr., was a key Republican minority member of the democratically controlled conservative Senate Committee on Finance, and he offered the amendment that the Senate accepted to permit states to adopt "experience rating." The Conference Committee accepted the LaFollette Wisconsin amendment without any real controversy and this provision has been in the federal law for nearly 50 years with no indication that it can be repealed, modified or tampered with in view of its strong support by the business community and the states, and despite its strong opposition by the labor movement. The principle of experience rating never has been specifically tested or adjudicated in federal court as far as I know.

Experience rating

Experience rating — the Commons-Wisconsin idea — today is primarily justified as a cost allocation device; namely, that it allocates the major cost of unemployment benefits to the business, industry, product, service or customer. The prevention argument is still heard occasionally in discussion but does not have the same force and effect that John Commons and Phil LaFollette thought it would. The workers' compensation analogy was

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[3] *For a broad and philosophic statement of the Brandeisian views opposing centralization and federalization, see Elizabeth Brandeis, "Centralization and Democracy in* Survey Graphic, *December, 1942, pp. 593-595, 607-608; and "What Road is Forward in Social Security," in* Problems of the Post War World, *McGraw Hill, 1945, pp. 55-84.*

[4] *"Paul Raushenbush was the administrator of the Wisconsin law for 35 years! It is the record for a State Unemployment Compensation administrator. I doubt if anyone else will ever approach or equal it.*

[5] *Message of Philip F. LaFollette, Governor of Wisconsin to the Wisconsin Legislature, Special Session, 1931, Tuesday, November 24, 1931, pp. 18-21. "I do not suggest that we have in some miraculous fashion discovered a cureall for the problem of unemployment. I do maintain that the only way we have made any progress in the past is from our experience. Out of the experience of the recent years we have learned certain things which indicate that certain steps are now necessary. I have no doubt that as we try the program which we are indicating, we shall discover both weaknesses and strengths where we did not expect to find them. But we shall never discover any thing or make any progress unless we try." p. 20.*

[6] "Adventure in Politics: The Memories of Philip LaFollette, *ed. by Donald Young, Holt, Rinehart and Winston, 1970, pp. 1963-1964.*

not as pertinent as he thought since the employer generally has less control over unemployment than he has over accidents.

It is generally believed by the critics and opponents of experience rating that employer support for reducing contribution rates through experience rating has had the effect of undermining the financial adequacy of state programs and stimulating the more recent cutback on benefits. On the other hand it has given employers a direct and strong interest in the program. The controversy continues.

Policy issues

Five policy issues precipitated strong differences of opinion among the proponents of unemployment insurance:

1. The first issue was whether the contributions of employers were to be kept in separate reserve accounts for each employer (and if such employers' reserves became exhausted, no further benefits from it would be paid), or whether all employers contributions were to be pooled and paid irrespective of the positive or negative amount of an individual employer's account. Although this issue was decided in favor of the pooled approach early in the mid 1930s, it must be recognized that the separate employer reserve account emphasis was a powerful factor in the enactment of the Wisconsin law as a political breakthrough. A major attack on the separate employer reserve responsibility was delivered by one of Common's favorite students, William Leiserson (first secretary-treasurer of the IAPES) who became chair of the Ohio Commission on Unemployment Insurance, which issued its Report in 1932.[9] The controversy was intense and proponents of the two ideas were called the supporters of the "Wisconsin plan" or the "Ohio plan" to summarize the philosophical difference between the advocates. The separate employer reserve account, so essential to the enactment of the Wisconsin law in 1932, did not survive. All states (including Wisconsin) soon adopted the pooled fund concept.[10]
2. The second major issue involved varying the employer contribution with his risk of unemployment, defined originally as the amount of benefits paid out. Initially called "merit rating," the attack by the opponents of the approach led to its eventual characterization by a more appropriate neutral terminology as "experience rating."

   Its critics argued that merit had little to do with the ups and downs of an employer's unemployment in a business enterprise but was more fundmentally determined by external forces such as the business cycle, the nature of the industry, interest rates and federal monetary and fiscal policies. Philosophically, the difference of opinion on this issue never has been resolved, but from a practical and political point of view experience rating now is deeply imbedded in the state and federal legislation and employer support for the program. The Commons, Groves, Raushenbush, Brandeis, LaFollette theory thus is entrenched strongly in federal and state law and practice. (Puerto Rico and the Virgin Islands don't have experience rating.)
3. The third major issue involved federal minimum benefit standards. This issue arose in the drafting of both the Wagner-Lewis bill of 1934 and the Economic Security bill of 1935. In passing, I must mention that the Wagner-Lewis bill of 1934, which Paul

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[9]Report of the Ohio Commission on Unemployment Insurance, *November 1932, pp 58-59. See also I. Michael Eisner,* William Morris Leiserson: A Biography, *University of Wisconsin Press, 1967, pp. 37-38. Leiserson, however, supported "merit rating" (pp 60-61.)*

[10]*Raushenbush and Raushenbush, p. 211.*

Raushenbush helped draft, did include minimum federal benefit standards. I never heard Paul explain this temporary lapse in his long opposition to minimum federal benefit standards. A major factor in the decision to omit minimum state benefit standards in the Social Security Act of 1935 was the fear that they might be a basis for the U.S. Supreme Court holding the federal provisions unconstitutional as an interference in the state's police power. Although federal minimum benefit standards have periodically been discussed and advocated at the federal level, the opposition of business and the states has been powerful enough to block any such action.

Paul Raushenbush during his career as a state administrator was the leader in the state opposition to federal minimum benefit standards. He had the support of business in Wisconsin and at the national level. It should be observed the national labor movement traditionally has supported federal minimum benefit standards. Labor's preferred public position is for a single uniform national system. In this matter the Wisconsin-Progressive political advocacy position has been at odds with the labor-liberal position.

It should be noted that the Wisconsin labor movement was cooperating with Commons in the support of Unemployment Insurance legislation between 1921-1931 when Samuel Gompers and the national AFL was cool or opposed to such state or federal legislation in this area. The national AFL did not specifically endorse Unemployment Insurance legislation until 1932.[11] I have not found any evidence as to whether the Wisconsin initiative had an impact on the AFL's change of policy in 1932. The Democratic platform of 1932 advocated "unemployment insurance under state laws." So the Wisconsin action of January, 1932, must have helped to reinforce the evolving nationwide trend.

4. The fourth issue involves federal operation of Unemployment Insurance and the Employment Service. Although the Employment Service was operated as a single national entity during World War II, there has been no substantial movement in recent years for the operation of the Employment Service or Unemployment Insurance by the federal government. Business and the state oppose such action. The national labor movement continues to support a federally operated system with uniform benefits across the nation, but it is not a practical high priority current issue.

5. The fifth issue is whether employees should contribute to Unemployment Insurance. Early advocates of Unemployment Insurance urged that some small employee contribution should be required in order to assure political acceptance of labor's involvement along with business in the resolution of political issues at the legislative level. With the serious impact of the "depression" this point of view was not supported by the labor movement. Business, however, during the 1935 consideration at the federal level, supported the idea of employee contributions.[12] The key factor in rejecting employee contributions was the inconsistency in having a uniform employee contribution with a variable employer contribution. Nor did it make sense to vary the employee contribution rate in tandem with the variation in the employer rate. To whatever extent varying the employer contribution rate was dependent on a philosophy or theory of incentives-disincentives with respect to unemployment, this assumption did not apply

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William Haber and Wilbur J. Cohen, Readings in Social Security, *Prentice-Hall 1948, p. 130.*

For the views of business in 1935 see the statement of the Business Advisory Council, Washington, DC, May 16, 1935. The business group recommended a grant-in-aid approach rather than the tax credit offset approach and employee as well as employer contributions to unemployment insurance.

to the employee and his relation to unemployment, especially if the basic assumption was that unemployment was primarily under the control of the employer.

Nine states at one time or other have collected employee contributions but only Alabama, Alaska, New Jersey and Pennsylvania do now. Pennsylvania enacted its provision very recently in order to assist in the restoring financial condition of its Unemployment Compensation program.

Three other policy issues in Unemployment Insurance continued to divide the friends of the program, although they did not become as identifiable as pro and con Wisconsin issues. These were:

6. Benefits to dependents of the worker. The strong advocates of "social" insurance such as Abraham Epstein argued that additional benefits should be payable to the spouse and dependent children of the unemployed worker. The opponents argued this injected a "welfare" principle into an "insurance" program and was therefore illogical and unacceptable. While several states adopted dependents' allowances, the issue has been a controversial one in federal and state Unemployment Insurance deliberations.
7. General revenue contributions to the Unemployment Insurance System. Again, the "social" insurance proponents argued that in order to reduce the regressive impact of payroll taxes on business, employment and lower-income individuals, part of the cost of the program should be met out of more progressive taxes such as federal income taxes. I was instrumental in obtaining a small general revenue contribution in the initial District of Columbia Unemployment Compensation law. But the idea of general revenue contributions only evolved when longer term unemployment benefits were added to the program by Federal action.
8. The appropriate federal contribution rate: 5 percent or 3 percent? The first Wagner-Lewis bill in 1934 proposed a 5 percent contribution rate. The 1935 Act embodied a 3 percent rate but even then provided for 1 percent in 1936, 2 percent in 1937, and 3 percent beginning in 1938 in order to enable the economic system to adjust to the increasing cost. The staff of the Committee on Economic Security estimated that a 5 percent contribution would pay benefits with a waiting period of 2 weeks for a maximum of 21 weeks and that 26 weeks could be paid only with a 4 week waiting period! These estimates were based on solvency from 1922-1933." The need for increased revenue to many state Unemployment Compensation plans has been a key issue in recent years as a result of recent recessions and the failure of the experience rating systems to generate sufficient reserves to handle continued high unemployment.

Concluding observations: looking back and looking ahead

The University of Wisconsin faculty and students and the state of Wisconsin all have played a significant role in the creation of many of the fundamental concepts and technical aspects of both Unemployment Compensation and the Social Security Act.

Sterling Hall has been a laboratory and fountain head where key ideas relating to social insurance were discussed as long as 80 years ago. Prof. John R. Commons advocated three basic concepts: (1) social insurance and the pooling of risks, (2) emphasis on prevention, and (3) effective administration. He did not invent the basic ideas, but he developed them into a philosophy of institutional economics and taught them to many students who were influential in putting them into practice.

"Social Security in America, *Social Security Board, Government Printing Office 1937, p. 87.*

I recall that when I was a member of Commons' seminar in 1934, he once told us: "If you ever have a choice between the perfect law, which is going to be badly administered, and a law which contains some doubtful political compromises but will be well administered, be sure to pick the latter."

We must acknowledge the important role played by Paul and Elizabeth Brandeis Raushenbush in their strong advocacy of state by state responsibility for Unemployment Compensation, experience rating and exclusive responsibility of employers for financing the program. The Raushenbushes opposed employee contributions, federal benefit standards and federal leadership.

John B. Andrews and his wife, Irene Osgood, Merrill G. Murray, Harold Groves, Edwin Witte, William Leiserson, Arthur J. Altmeyer, William Haber and myself — all students of John R. Commons — played various roles in the development of Unemployment Compensation in the USA. I am sure there were several more.

After 50 years, there is a reasonable basis for arguing that some important changes and reforms are necessary and desirable in the federal-state Unemployment Compensation program. I would list five controversial changes as follows:[4]

1. Some specific federal benefit standards to assure a reasonable degree of long run adequacy of benefits, especially when high levels of unemployment occur.
2. A federal-state reinsurance plan to assist in a more equitable system of financing state costs when high levels of unemployment occur.
3. A more adequate revenue base including an increase in the federal maximum earnings base.
4. Some modification of the federal revenue funding and budgeting arrangements to assure a more effective administration of both Unemployment Insurance and the Employment Service.
5. A supplementary system of federal and state financial aid for unemployed persons primarily for persons who are not Unemployment Insurance benficiaries (unemployment assistance).

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[4] *For some other various proposals for change see Wilbur J. Cohen, "Some Major Policy Issues In Unemployment Insurance and General Assistance," in* Studies in Unemployment, *Special Committee on Unemployment Problems, U.S. Senate, 86th Congress, 2nd Session, 1960, pp. 311-341.*

Outstanding ideas form UI's foundation

by Richard Wagner

Inscriptions adorning the Archives Building in our nation's capital contain this wise advice: **The Past is Prologue — Study the Past.**

What better way to begin this history than from the notes of an unidentified though earnest member of our own public service family made 25 years ago? They read:

> "Remember that this year is more than the dawn of a promising new decade. 1960 also marks the 25th anniversary of the founding of our great and too long unsung Federal Unemployment Insurance System. It is indeed, and mark this well, a truly federal system, for in it our state government and our national government have combined both in its birth and its maintenance. And it is truly an insurance system for what we call 'contributions' and 'payroll taxes' are, in reality, the insurance premiums which finance this highly efficient enterprise that protects and benefits the public at large, as well as those who suffer direct wage losses.
>
> "A quarter of a century may seem ages to some of you, though to many of us it seems only a short while since Congress enacted those provisions of the 1935 Social Security Act that supplied the incentive sparks and the drafts of 'model laws' which started the stages on their way. On the way to 'development and experimentation in their separate state laboratories', all in the hope that

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one day a supremely excellent uniform state law would emerge. (1935! Dr. Alexis Carrel, assisted by Col. Charles Lindbergh, invented an artificial heart at the Rockefeller Institute in New York. The first women were admitted to membership in a security exchange and opera directorship. Congress that year also authorized the Works Progress Adminsitration to create useful public sector employment, and our blessed country, in the midst of the depression, took heart in its future.)

"The average weekly wage was only about $25 when we started paying insurance 'benefits' — that was in 1938 — and $15 a week was probably the highest payment anywhere for a maximum duration of 13 weeks. One strong feature then is worth remembering: of the $26 billion wages the 20 million covered employees earned that year, almost all, $25 billion, were used as the base on which 'premiums' were calculated. (Would that this feature of the system had remained.) Nearly half a billion dollars were paid in one year at the outset — which, believe it or not, dropped to much less than $100 million yearly in 1943 and 1944 at the height of our involvement in WW II. Last year (1963), with an average weekly wage of $90 among 40 million covered workers who earned $187 billion, the Unemployment Insurance System paid more than $2 billion benefits, second only to the $3.5 billion paid in 1958! Those were 'the finest hours of this great public insurance system' it has been said. Again we stress: the entire population, not just those 10 million unemployed workers who received benefits, were beneficiaries of this insurance system.

"While we are dwelling on the public benefits of Unemployment Insurance, keep in mind that the costs charged to industry (but mainly paid by the general public in the prices of goods and services) have been far less proportionately than those of insurances in the private sector. Workmen's Compensation Insurance for occupational injuries, for example, has experienced premiums of approximately two dollars for every dollar of compensation paid for medical expenses and wage losses. Much of this has been the costs of administration by the insurance companies who are the real administrators of that system. In our Unemployment Insurance System, administrative costs have generally been less than five percent of total premium. We have produced a record of efficient performance in this discerning, human and often complex program of which we can be proud.

"Much deserved pride is equally due in the reputation that the Unemployment Insurance System has earned for professionalism in government service. When crises and perplexing problems have arisen from time to time, governors and other branches of state governments have called upon our agencies for staff assistance and advice. From 1935 until today, the contributions this Federal Insurance System has made to our society and economy in ideas and dedicated performance, in standards of excellence and justice, have been shining pages of history too long kept under a bushel.

What follows is simply a summary of outstanding ideas, standards of excellence and quality service that the federal Unemployment Insurance System has contributed to the country's well-being.

1. **The presumption of coverage of all workers, rather than the narrow 19th Century master/servant tests.**

   Fortunately, scholars at the inception of the UI System foresaw what might happed if doors were left open arguments — that all a firm had to do to avoid liability was

describe employees as "independent contractors" and put the burden on the workers to prove that they were "subject to control over the manner of performing their duties." Recommended drafts of laws provided for broader and stricter tests of the employment relationship. "Three-way conjunctive tests" (or at least "Two-way") in which control was just one factor provided assurance that laid off claimants would not be turned down as having been "self-employed" unless they were genuinely independent operators.

Companion provisions outlawed any agreements to waive one's compensation rights. That gave further protection against exclusions from coverage by legalistic and tricky language based on theories of immunity from liability that had developed in the early 1800s in other fields.

One hardly can overestimate the beneficial, practical effects that these enlightened features of the Unemployment Insurance System have had in its operation (as well as in other fields such as Workers' Compensation). Recent efforts to sell so-called "management services" to employment units that could convert their employees into "independent contractors" and "self-employed entrepreneurs" have, consequently, met little success in Unemployment Insurance.

II. Fair hearings before impartial tribunals: new/old ideas have spelled justice

Again, the vision of writers half a century ago and their implementation of these visions through the years in this insurance system have established rights for millions of beneficiaries in this and other government programs. Substantive rights to such things as compensation and insurance often can be impaired or even defeated if procedural rights for their enforcement are defective.

The founders knew that in the common law, which our nation inherited the function of a judge was to "supervise the administration of justice;" not just to sit like a bump on a bench presiding at a battle of wits between adversary lawyers like a referee in a prize fight.

They knew, too, what had happened at times to these concepts of "procedural due process" (fair play) in the 19th century when laws had been changed to silence judges as spokesmen for justice at trials! The advocate lawyers called this "judicial tyranny" and wanted no interference with their roles as salesmen of their own views of how cases should be heard and decided. The 1935 writers wisely wrote that anyone whose claims were denied — and, it followed, any employer, too — should have the very important practical right to fair hearing before an impartial tribunal.

A "fair hearing" means an informed, open hearing where the parties know their rights, where the decision maker sees to it that they do, and accordingly participates in the proceedings in the interest of justice. To be an "impartial tribunal" does not mean to be disinterested in justice or unmindful of the public interest. As a wise judge, who had also been a legislator and attorney general, put it:

> "The Unemployment Compensation Authorities have a duty to every covered employed person to protect the fund against claims of those not entitled to payment out of it. They likewise have a duty to every person covered by the law to see that such person receives from the fund that to which he is entitled. An unemployment compensation case is not a lawsuit between an employer and the employee; although it has sometimes mistakenly been considered as such."

It is good for everyone that these standards of fairness became firm parts of the UI System. With all of the misguided attempts that have been made to dilute and trim these individual rights, it is not hard to imagine what would have happened

without their presence in the original laws. The raw "adversary system" in which justice supposedly will emerge from turning two self-motivated advocates loose to outsmart or to outshout each other, and the Devil-take-the — hindmost, is least of all suitable for systems of public insurances. What has developed is, in reality, a built-in ombudsman (everyone's representative) system with the promise of concerned, fair treatment for everyone in the vast and often necessarily hurried public enterprise.

III. Prompt payment of unemployment insurance claims

Perhaps experience with tolerable delays in the private sector workers' compensation systems — where insurance companies and large employer units permitted to self-insure are the real adminsitrators — led the 1935 founders of Unemployment Insurance to foresee what might happen without guarantees that claims would be paid promptly.

So it was that this assurance — that state law must provide for "methods of adminsitration . . . reasonably caculated to insure full payment of compensation when due" — was cemented into law!

Even so, it took years before this requirement by Congress as a condition for a state to qualify for funds for administration was effectively applied and enforced. This writer remembers well how successive appeals from decisions awarding compensation delayed many payments, and at least one large coal company, which appealed every claim filed by one of its employees, thus potsponed all Unemployment Insurance payments several months in its areas. Later some stated adopted what came to be called "double affirmation" clauses — stating that after two decisions in favor of a claimant's eligibility Unemployment Insurance benefits were to be paid forthwith, not withstanding further appeals. Even such assurances often were challenged.

Indeed, it was not until 1971 that the full value of the 1935 pay-when-due guarantee was cemented in the system by the United State Supreme Court in an unanimous opinion written by Chief Justice Warren Burger, himself! This was in the now famous Java Case. The court made it clear, at last, that the 1935 requirement means pay promptly when the first administrative decision as a result of a valid hearing directs that claims be paid.

This development also has contributed to the evolution of greater fairness in other fields of government and insurance administration.

IV. Personnel standards maintained on merit basis

One of the national requirements for administrative grants to states in the UI System is that the state law makes provision for the "establishment and maintenance of personnel standards on a merit basis."

This is yet another field of public administration to which our Unemployment Insurance System has contributed examples of excellence. It paved the way to continuity of knowledgeable staffing of government agencies.

At the time this requirement was enacted, Civil Service was relatively unknown in state governments. Even as late as the 1940s some state legislatures were still balking at the idea of placing the position of hearing and decision making officers (so-called "referees" or "administrative judges") on a merit basis. Other assaults have been made on the concept of merit selection of public employees. As recently as the last two decades measures have been undertaken to remove from classified Civil Service any positions involving "participation in policy making," — a phrase that is so elastic and vulnerable to distortion that it could strike at the very roots of "continuity of knowledgeable staffing."

V. Advisory councils with public members

Can you imagine a multibillion dollar enterprise without a board of directors to look out for the interests of the shareholders and the future of the firm? Or at least a board of monitors qualified and responsible for maintaining a knowledgeable overview of corporate management's performance?

Consider then the operations of these vast state run insurance enterprises, which have paid some $200 billion to unemployed workers, about half of this in the last 10 years. In some states the system has paid as much as $2 billion in one year alone to nearly a million persons! Consider, too, how overall top management individuals of states are chosen for only four year terms — often for only two year terms in legislatures — and that they no sooner take office than they become reminded of what political action groups will say and pay in anticipation of the next election.

It is not surprising, therefore, that even a half-century ago when multimillion dollar payouts served much smaller populations farsighted national partners in our federal system urged the establishment of advisory councils to overview these public insurance operations in the interest of "impartiality and freedom from political influence" — in the interest of the public at large, that is not just those of organized business and labor spokesmen. With only a few exceptions state laws have since provided for one or more public members of UI advisory councils. This is another fine contribution to sound concepts of representative government that our Unemployment Insurance System has provided through the years!

Half a Century after the birth of Unemployment Insurance, and after a decade of the most difficult times it has experienced (during which it again reached its "finest hours" of service) 1985 can become the dawn of a new era of both social justice and public insurance. It deserves far greater recognition than it has received thus far, and something needs to be done about this to preserve its great potentials. As a Pennsylvania Bar Association institute on continuing legal education observed only last year:

> "The law and the workings of this public insurance system are almost as unknown as they were in 1938 (the first year of benefit payments) by most of that fortunate part of the population who have had no experiences with layoffs. This is not as it should be with a law that has been putting millions of dollars into every borough, city and crossroads."

The unsung heroes of this great public insurance system are its visionary founders, who studied the past to plan for its future, and rank-and-file public service workers, who quietly and honorably did and still try their best to carry out its traditions and promises.

One state's experience: 1939

by Joseph Bildy

While more than a million people watched bands waltz through the streets of Philadelphia, and millions more spent a second day nursing hangovers, William W. Lawrence prepared his staff for action. It was Jan. 2, 1939. The following day Lawrence, Newark office manager for the New Jersey Unemployment Claims Commission (UCC) would see his workers, including senior claims examiner Karl H. Platzer, process some of the first Unemployment Insurance claims filed in the state.

When Lawrence and Platzer arrived early for work on Jan. 3 at the Sussex Avenue Armory, where a temporary office had been established to handle the expected overflow of claimants, they found Jerome Yesavage, a 23-year-old former tool attendant, waiting to file the first claim. Yesavage was joined by more than 24,000 claimants across the state that day as New Jersey UCC offices began a tradition of service to the public that has endured to the present.

In 1939 Unemployment Insurance was a concept whose time had already arrived in most industrialized countries. The idea that government had some obligation to mitigate the effects of the ebb and flow of economic cycles on workers had its origins in 19th century Germany and, by the conclusion of World War I, had spread to most European countries.

The end of that conflict saw widespread unemployment on both sides of the Atlantic. A conference on the problem, called by President Warren G. Harding and chaired by Secretary of Commerce Herbert Hoover, did little except suggest further investigation through the auspices of a permanent committee on unemployment.

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As the postwar economy recovered there was even less interest in Unemployment Insurance, although a few forward looking businessmen instituted private insurance plans within their corporations. Economists who vainly argued for compulsory state supervised Unemployment Insurance during the decade claimed that it would actually prevent unemployment, as employers would not want to pay the increased rates produced by large layoffs and would thus find some way to keep their workers employed.

The great "depression" of 1929 overwhelmed the few private compensation plans in existence and produced an army of unemployed who were forced to survive on local "relief" payments. Within a short period of time it became apparent that local and even state authorities did not have the resources to meet the challenge and that a more coherent system of assistance to the unemployed was necessary.

The beginning of a real nationwide unemployment insurance system dates from 1935 when the Social Security Act required its establishment. Due to political opposition and a fear of Constitutional challenges the act left actual implementation of programs to the individual states. With the Social Security Act, the United States became one of the last major industrial nations to establish an Unemployment Compensation program.

New Jersey accepted first claim Jan. 3, 1939

State legislation in conformity with the Social Security Act led to the creation of the New Jersey Unemployment Claims Commission, with exgovernor Harold Hoffman named as executive director. Organized in 1938, the commission established a date of Jan. 3, 1939, for acceptance of the first benefit claims. Hoffman expected more than 50,000 people to file initial claims on Jan. 3, and, with this in mind, set up 18 temporary offices in National Guard armories to supplement the commission's 35 regular offices, which were colocated with the Employment Service. Although the actual number of claimants that first day fell far short of Hoffman's estimate, Jan. 4 saw an additional 15,000 claims filed.

Prior to filling out their claim forms, claimants were handed a small blue booklet which, by means of a question and answer format, informed them of eligibility requirements and benefit rate computations. The maximum benefit rate was $15 per week, payable for a maximum of 16 weeks. The minimum rate was $5 and partial earnings of more than $3 in a week resulted in ineligibility for that week.

Newark Evening News reporters, who were present at the Sussex Avenue armory site, also interviewed claimants and workers throughout Essex county. They found Harvey Woodall, who said he had been out of work since May, 1938, first in line at the Orange armory. Frank Hardy, of East Orange, whose claim was disallowed because his earnings of $73.40 fell short of the $80 required for a valid claim, was heard to say that he intended to "appeal to higher authorities." Both Newark and Orange had heavy turnouts on the opening day, but the Belleville office, located in the town hall, had only four applicants by 11:00 a.m.

Women filed claims at separate offices

Women within the Newark office area were instructed to report to the Employment Service office on Washington Street rather than the armory site, which served only men. A reporter described the women as ". . . sales clerks, factory workers and machine operators" who had ". . . lost their jobs in economy waves or their work was only temporary over the holiday season." He added, as if surprised, that "smartly dressed well spoken women were numerous among the group brought together by the common bond of being out of work."

After establishing eligibility claimants had to satisfy a two week waiting period before receiving benefits for their third week of unemployment. On Jan. 26, 1939, the first unemployment benefit check in the history of the state of New Jersey was mailed to Ernest E. Richardson of Union City. Richardson was joined by 5,999 other claimants whose checks were mailed that day.

Arthur Mudd, director of the N.J. Financial Assistance Commission, suspected that some of the claimants may not have deserved their checks. Mudd told the press that he had devised a new "checking system" to prevent "duplication of payments from the state's relief and unemployment agencies." Incredibly, he seemed to have found none.

A few try to beat the system

There were a very few people who did try to beat the system. On May 10, 1939, a man then living in New York City was arrested and held on $5,000 bail for working in New York while collecting unemployment benefits in New Jersey. A former Jersey City resident was accused of defrauding the UCC of $120 in benefits.

Perhaps due to the Ingle revelations, the UCC established a task force to investigate the incidence of wage-benefit conflict. In a study more comprehensive than that conducted by any other state, New Jersey investigators discovered two cases of willful fraud out of 14,000 claims reviewed. Their report stated that it "appears reasonable to conclude that fraud in the payment of benefits in New Jersey is almost nonexistant."

On July 20, 1939, the one millionth New Jersey Unemployment Insurance benefit check was mailed. The first six months of activity for the UCC heralded an auspicious beginning for a program that, over the years, has provided not only financial security for those who have earned its coverage, but also a feeling of psychological security for workers and their families which has no doubt contributed to on-the-job proficiency. All things considered, the Unemployment Insurance program, which celebrates the 50th anniversary of its inception this year has contributed to the overall progress of both business and labor in the state and the nation.

Technology and the UI System

by Charlie Ballard

The Unemployment Insurance payment systems have kept pace with the many technological advances achieved by our society from the beginnings in the 1930s up to the present.

The federal-state partnership has been a major factor in the progress that has been achieved. As technological advances were recognized, the United States Department of Labor took the lead in various pilot projects to determine if there were applications that could be beneficial to payment systems. In cases where progress was demonstrated, these systems were exported to other states. The history of these systems has proved this effort to be of great benefit to claimants, employers and the UI system itself. The improvements always have been cost effective and have saved staff time while improving the speed of making payments.

The other benefits achieved by automation include providing clear audit trials of payments, prompt notification of employers and fraud detection as evidenced by various crossmatch systems between payments made and wages reported.

The earliest payment systems in the 1930s were entirely manual. Wages were reported by employers and processed, stored and accessed manually. Checks usually were typewritten, and posting of payments made and benefits available to claimants either were handposted or typed (on a manual typewriter, of course).

The 1940s brought on the advent of posting machines. The machines updated various records by a faster, more accurate and standard manner. Checks still were typed in most systems.

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The 1950s brought the first real change in new technology. The punch card made its appearance. These were used in combinaton with electronic accounting machines (EAMs). There was no electronic storage of data, but various EAMS were used for card punching, interpreting and sorting. Checks and various types of control cards were produced. Wage records from employers also were added to this system. This enabled storage of data and a standard means of retrieval of usage.

1960s brought the first computers

The 1960s brought the first computers. These early machines had small storage capacities and were used in conjunction with the punch card system that was already in place. Some inhouse programming was initiated, and most agencies formed separate data processing departments. Speed of processing and elimination of repetitive manual operations resulted. The foundation of computer automated systems was being built.

The 1970s brought bigger and faster mainframe computers, with the accompanying increase in programming creating new and more responsive systems. The Department of Labor sponsored pilot projects to aid in the expansion and advancement of computer capabilities. These were exported to various states aided by cost [illegible] e cost recovery plans. In spite of huge increases in workloads, states were able to kee[illegible] accomplish more with less only because of computer expansion.

This period of time saw the increase of audit trails and the availa[illegible], of access to store information. Computer terminals were added in all states. Many were placed in local offices for instant access of information as it related to employees and claimants. Many different systems were tried. Local office input of claims for benefits was started. This was accomplished by terminal entry, outstationed card readers and some optical character reader equipment. The end result was a more responsive payment system that could pay for itself by a reduction in staff time.

1980s brought higher level of technology

The 1980s brought a major move away from punch cards, reflecting the same move in private industry. Paper checks, rather than card checks, became the standard. Many states completely eliminated punch cards with online data entry and computers with the necessary massive storage capabilities. Optical character readers were used with more frequency. Networks have been established for transfer of information among states, and major strides have been made in detection of fraud by intersate claimants. Payment systems of interstate claimants were changed for the first time. Speed both of check delivery and of responses to claims filed resulted.

After 50 years of progress, the Employment Security family stands ready to perform even beyond past accomplishments. This is the only system in the country that has the ability to make weekly payments and vary these payments weekly according to what happened the prior week. This system is constantly being improved and refined. It has demonstrated the ability to react almost immediately to federal law changes, local disasters and an ever changing workload. The system stands as a testimony to 50 years of progress by the federal-state partnership of the Unemployment Insurance System.

Unemployment Insurance: The System

by William U. Norwood, Jr.

Looking back over the 50 years since the federal-state Unemployment Insurance system was created as a part of the social security "safety net," one cannot help being impressed by the political courage of the Congress in enacting what had to be regarded in 1935 as a visionary experiment of far-reaching significance. The imposition of a federal tax, with a state tax offset provision, was calculated to require each state to do what only Wisconsin previously had done: establish a state Unemployment Insurance program.

State legislatures were left with no real choice except to enact the necessary legislation. To do otherwise was to allow employers to pay the federal tax without any portion being collected by the state for benefit purposes. Needless to say some state legislatures were not enthusiastic about enacting the program, but they did move fairly promptly to do what was necessary. They relied very heavily on draft language furnished by the Social Security Board, which accounts for similar provisions in many state laws particularly in the early days.

In each state it was necessary to designate an existing state agency or create one specifically for the purpose of administering the program. Furthermore, because it was required that personnel administering the program be selected on a merit basis, most states had to create merit systems for this purpose. There had been no prior need or requirement for such a selection process for state employment. (All states now have merit or civic service systems largely as an outgrowth of this particular requirement.)

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The burden then fell on the fledgling Unemployment Compensation agencies (as they then generally were called) to implement a new, strange and complex program. After the passage of all these years it is difficult to appreciate the enormous task facing those early stewards of the system.

Organization of agencies

Within roughly a two year span the agencies had to be organized; personnel had to be hired and trained; the program had to be publicized; employers had to be searched out and a determination made as to whether they were covered by the program. Those found to be liable had to be advised of their reporting and tax payment responsibilities. Forms had to be designed, printed and distributed to liable employers. Procedures had to be developed and installed for receiving and processing tax and wage reports. A structure had to be developed and procedures established for the taking and processing of claims for benefits and the issuing of payments to qualified beneficiaries. Employment Service offices had to be established and staffed and personnel trained to be ready when benefits became payable.

During those early days the federal-state relationship began to take on a clearer outline. The states obviously had responsibility for operating the program, but the federal government just as importantly had the role of providing guidance, technical assistance and financing. In those days everyone was a novice, but the federal governments by passing along the developing "state of the art" was able to help the states avoid the necessity of "reinventing the wheel" in each and every jurisdiction.

As busy as each state was getting its own program geared up, there also was an awareness of the need for interstate arrangements for the taking and processing of benefit claims. Indeed, it was the necessity to convert a state-by-state system into an interstate system. This brought about the first meeting of state Unemployment Compensation administrators in 1936. From that meeting emerged the basic acceptance of agent state/liable state roles and the creation of the Interstate Conference of Unemployment Compensation Agencies (now ICESA).

Thus, by the time benefits generally became payable in 1939, the UI system was fully operational with three salient characteristics already apparent. First it was staffed by qualified career professionals selected on a merit basis. Second it was a state operated, federally mandated and (to some degree) directed system. Third it was a state oriented program that accepted and acknowledged an interdependence between the states. These are still its essential characteristics and basically its strengths.

Benefits first became payable during the recessionary years of 1936-39. Those early claims loads were heavy, but the agencies successfully met the crucial test. By the end of 1939 the responsiveness and competency of the system were pretty well established.

If Congress had not created the Railroad Unemployment Insurance program as a separate system in 1938, it quite likely would have remained a part of the basic system because after the state systems became operational no compelling case could have been made for separate treatment. Ironically, there is once again serious consideration of merging railroad UI with the state systems.

The World War II experience

Beginning in 1940 the defense buildup and mobilization effort had the effect of materially reducing claims loads with a very pronounced drop during World War II. While the

Employment Service was federalized and operated under the War Manpower Commission, the UI agencies spent the war years primarily collecting taxes while paying out very little benefits, but planning for the anticipated heavy claims loads that were expected to occur during the postwar readjustment period. The fact that those loads did not materialize as expected was fortunate in light of another development.

In 1944 Congress had passed the Servicemen's Readjustment Act, which provided a wide range of benefits for returning servicemen such as education allowances and GI loans. Also included was a provision for Servicemen's Readjustment Allowances (SRA) of $20 a week for up to 52 weeks. The Veterans administration, which had overall responsibility for administering the act, chose to have these weekly readjustment allowances paid through the state UI agencies because of their established capability for making payments to the unemployed on a weekly cycle. This was the state agencies' first experience in making payments for entitlement on any basis other than earnings in covered employment. These loads were much heavier than regular state claims and the agencies had to expand their staffs rapidly to handle this so called "52/20 program." They handled it very well and paid out $3.8 billion to some 8 million individual veterans during the immediate postwar years. Just as regular UI benefits had helped ease the impact of unemployment on the economy, the SRA payments helped materially to facilitate the transition from a wartime to a peacetime economy and workforce.

In 1952, toward the end of the Korean conflict, Congress again provided an array of benefits for returning servicemen. Included was a program of Unemployment Compensation for veterans. The basic entitlement was $26 a week for 26 weeks, and this time the program was made the responsibility of the U.S. Department of Labor to be operated by the state UI agencies. This program as more closely related to regular UI operations but again entitlement was determined by a period of military service rather than prior covered employment, and once again the states served as agents for the federal government.

Based on the experience with SRA and UCV, Congress now decided in 1954 to cover federal employees and to have them paid benefits in accordance with the provisions of state law. This same concept was embodied in the coverage of exservicemen in 1958. This was a novel but logical extension of the idea of a federal program being delegated to and operated by the states.

Extended benefits

Meanwhile changes in state legislatures had liberalized benefits so that the maximum duration of benefits was generally 26 weeks. However, in 1958 there began to be an awareness that during periods of high unemployment many claimants would exhaust regular benefits and remain unemployed. To encourage states to pay extended benefits during such periods Congress provided in 1958 to loan funds to states for payment of temporary benefits beyond 26 weeks. Under this provision a claimant could receive up to 39 weeks of regular and extended benefits. In 1961, during another economic downturn, Congress assumed direct federal responsibility for benefits after 26 weeks. While the states handled their responsibilities satisfactorily, the programs in both instances were initiated only after congressional recognition of the problem and action to meet it.

These experiences caused a general acceptance of the fact that the program could be more responsive to the needs if some type of standby extended benefit provision was available to be utilized when claims loads substantially exceeded the norm. After years of deliberation Congress in 1970 enacted a permanent extended benefits program to be activated by a combination of state and federal triggers. While there have been frequent

modifications of these provisions and a complete elimination of the federal trigger in 1981, they have caused the system to be more quickly responsive to changing economic conditions by triggering "on" or "off" as claims loads fluctuate. This has caused additional stress and complexity within the system and unfortunately some lack of understanding on the part of claimants and the public. Furthermore, it has also been overridden by congressional action through additional extensions to regular and extended benefits for as long as 65 weeks on one occasion (1975). However, the concept of a state UI system responding to conditions of heavy unemployment by automatically extending benefit payments has enhanced the reliability and responsiveness of the state UI systems as a means of replacing wage loss at a critical phase of the economnic cycle.

Demands on system

The system has also been asked at various times to take on more or less related responsibilities such as trade readjustment allowances, disaster unemployment assistance, and supplemental unemployment assistance. These have again followed the pattern of the states acting as agents for the federal government for each of these special programs.

Programmatic changes such as extension of coverage, increase in taxable wage base, reduction of waiting week requirements, extension of duration and wide variation in employer tax rates because of experience rating have been a continuing feature of the program almost from its inception. All these have added to the complexity and extensiveness of the program. This article has not dealt with these matters in any detail since its purpose is to focus on the system itself.

Some of the founding fathers of the system would be dismayed by many of the things the system has been called upon to do, but they would undoubtedly be proud of its performance in good times, bad times, wartimes and peacetimes. They would be amazed to see how well the system had dealt with variations in workloads through use of base and contingency staff, with its ability to cope with tremendous workloads through utilization of the latest available computer equipment and techniques and with its constant striving to assure the integrity of the program while preserving the dignity of its beneficiaries.

For all its diversity and its divided federal and state responsibilities, it has met the challenge of being ready when needed as it did by paying out more than $25 billion in 1983 and materially reducing the depth of the economic cycle in that recessionary year. Notwithstanding interstate rivalries and federal-state stresses, the system has more than proved its worth over these past 50 years. In the final analysis, it is the people who administer any program that cause its failure or success, and in the case of the UI program it is the people who collectively constitute the system that have caused it to fulfill its promise.

Part II: Financing the system — benefits and administration

Fifty years of state financial responsibility

by Joseph M. Becker, S.J.

After the United State decided 50 years ago to have an Unemployment Insurance System of some kind, the next major decision was whether to have a single, uniform system determined by Congress or one in which each state would be responsible for its own program. The leading voice of those favoring state responsibility came from Wisconsin, which had enacted its own Unemployment Compensation program in 1932 and hoped to induce Congress to pass legislation requiring all other states to do likewise.

The Supreme Court of the 1930s presented a possible obstacle to this strategy. A federal law compelling each state to pass such legislation would likely be declared unconstitutional. A way around the difficulty was discreetly hinted at by Louis D. Brandeis, a justice of the United State Supreme Court and father of Elizabeth Brandeis. Elizabeth recently had married Paul Rausenbush, and the two young economists were working together devising the shape that Unemployment Insurance might take. They were spending the summer of 1933 at Chatham, the summer home of the justice. I heard the story much later when I was visiting Paul and Elizabeth at Chatham. The young people had talked a great deal in the presence of the justice about their UI problem.

One day, at luncheon, apropos of nothing at all, the justice launched into an account of how Congress had finally devised a way to impose a national inheritance tax that would not be declared unconstitutional by the Supreme Court. The device was the simple one of Congress providing that citizens would not be bound by the federal law if their state itself passed a similar law. "We were sitting right at this kitchen table," I was told

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"when he narrated this bit of legislative history." Recognizing the delicacy of the situation, Paul and Elizabeth refrained from asking the justice about the possible application to UI, but from that time on they did in fact pursue this objective. It was the approach finally adopted by Congress and allowed to stand by the Supreme Court.

Franklin D. Roosevelt gave his full support to this approach. Roosevelt had a long record, even before he became governor of New York, of favoring a federal, over a national, form of government. Influenced by the eminent historian, James Lord Bryce, he shared Bryce's view that the states could serve as laboratories in which various approaches could be tried without committing this very large, very heterogeneous country to any one approach.

The choice between assigning responsibility to the federal government or to the state governments involved the basic principle of subsidiarity. This principle states that a higher unit of society should not undertake to do what a lower unit can do as well. According to this principle, the smaller units of society (the individual, the family, the private organization, the local government, the state government) enjoy a certain preference and are given the benefit of the doubt when a choice must be made between one of them and a higher unit. On the contrary, the larger units must bear the burden of proof. Since so often in social affairs convincing proof is unavailable, this assignment of benefit of doubt or burden of proof can make substantial difference in how a society is organized. The chief difference between our society and that of the Soviet Union, for example, is the greater extent to which we use the principle of subsidiarity. We made use of this principle 50 years ago when we assigned to the states chief responsibility for Unemployment Insurance.

State responsibility touches the UI program in many different ways. This review is limited to state financial responsibility. How did the states carry out their responsibility for raising and spending the money needed for unemployment benefits? At this point I can hear someone saying, "You would think that a clergyman would be the last one to choose financing as his topic; he would be talking rather about values." Quite right, and values are, indeed, my interest. When I was invited to write on financing I was glad to accept the invitation because a discussion of financing is a direct road to the discussion of values. A visitor from Mars who had only a day to spend in our country and wanted to find out all he could about our values, might well spend most of his time examining how we handle our money. Our budgets are the mirrors of our values.

The half century of Unemployment Insurance history consists of two very unequal parts: the first 45 years of its existence and the recent five years. The analysis provided here has focused chiefly on the first part because it represents almost the total experience and because 1985 is too early to know whether the recent experience represents a temporary or permanent deviation from customary patterns.

This review is concerned with the question: "How wise was our original decision to make each state responsible for its own costs?" The answer to that question requires the application of two norms -- one relating to the total tax burden borne by the states, the other relating to the distribution of that burden among the states.[1] These are the familiar norms of solvency and equity.

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[1] Appropriate to the examination of 50 years of experience, our view here is from a high hill, where details are suppressed in order to discern the general features of the landscape. The review draws upon previous books and articles of the author on the subject of UI financing, omitting the statistical tables and detailed analyses of those studies.

Solvency

The essential test of solvency is simply this: Were the funds always available to pay the convenanted benefits? The answer to this question is clear enough: all legitimate claims in all the states always have been paid. During the first 40 of its 50 year life, that simple proposition suffices as an answer to the question regarding solvency. But in the last decade a new situation has appeared. In the decade 1975-1985, 40 states exhausted their UI funds (''went bankrupt'' as the newspapers liked to put it) and had to borrow from the federal government. At its peak, the combined state debt totalled $14 billion.

In judging the significance of this development two questions need to be answered: (1) How successful have the states been in repaying their debts? and (2) Why did they have to borrow in the first place? The first question is the essential one. If borrowing states always repay, the principle that each state is responsible for its own costs remains inviolate. Buying on credit, if followed by repayment, is a normal business practice that carries no stigma. On the other hand, failure on the part of the states to pay their debts probably would bring basic changes in the present federal-state relationship.

For a time there was much anxiety expressed over the supposed inability of the debtor states to make repayment, and many proposals were made to lighten or forgive these debts. It is significant that these proposals did not come from the taxpayers themselves, that is, from the employers in the states with the debts. On the contrary, at the hearings held by the National Commission on Unemployment Compensation on each occasion when the question of easing the burdens of the debtor states came up representatives of employers argued against any relaxation of the principle that each state be responsible for its own costs. They declared that they would pay off the debts in their states without federal help. This was true even for the states with the billion dollar debts, such as Michigan, Illinois and Pennsylvania. Congress chose to heed this advice, holding each state responsible for its total debt. Indeed, Congress chose to increase each state's fiscal responsibility by legislating that whereas in the past such loans had been interest free, future loans would carry an interest charge.

On this fiftieth anniversary it is possible to report that the states have been repaying their debts at a reassuring rate. As of mid 1985, the total debt has been halved to $7 billion. Of the 40 borrowing states 25 have repaid entirely, leaving 15 still with obligations. The four largest debtors (Illinois, Michigan, Ohio, Pennsylvania) each have repaid a billion dollars of interest bearing loans, but each still owes a billion dollars of interest free loans. These obligations were incurred in the early years before Congress changed the law. States with such debts seem to prefer to let the automatic operation of ''credit reduction'' effect the repayment of these costless obligations. The chief danger faced by these states is that another recession will catch them with their reserves still low.

It would be misleading to end the history of state responsibility there. All is not well in that history. So many states should not have had to go to the federal government for so much help. Does the experience indicate a basic flaw in the system that can be expected to produce a similar, perhaps worse, experience in the future?

A quick, panoramic view of solvency history will provide the perspective needed to understand recent events. During the years of World War II, with their low unemployment and high wages, the system became overfunded. During the postwar years the reserve funds were strong enough to permit a simlutaneous liberalization of benefits and a decrease in taxes. This long period of adequate, even excessive, reserves engendered

a feeling of security whose basis eroded so gradually that it escaped notice. Some states became accustomed, one might almost say addicted, to the low range of tax rates made possible by the previous favorable history.

Reasons for state insolvency

The 1950s brought enough experience with heavy unemployment to indicate the dangers of letting funds run down: three states found they had to borrow from the federal government for a short period. But then came the 1960s and the most sustained period of prosperity in our history. Again the states were lulled into a false security, and the decline of reserves begun in the post-war period was allowed to continue past the point of safety. In 1959, following the severe unemployment of 1958, the Interstate Conference of Employment Security Agencies (ICESA) had developed a measure of solvency called the "reserve multiple." ICESA recommended that a state maintain a reserve multiple in the range of 1.5 to 3.0, depending on each state's particular situation. Many states, including most of those that later exhausted their reserves, failed to follow this guideline.

Persistent inflation also played a significant role, especially in connection with the taxable wage base. As wages rose benefits automatically rose with them, but taxes did not do the same because the taxable base remained fixed. For about a quarter of a century taxable wages as a proportion of total wages fell almost without interruption. A gap tended to develop between fund outflow and inflow. The decline in the effective tax base could have been offset by repeated increases in the tax rate (or gross base) but whereas the decline in the effective tax base was automatic, an increase in the tax rate (or base) required legislative initiative, which was not always forthcoming.

During this long period when the fiscal basis was weakening, benefits were being liberalized, especially the duration provision. Duration was increased at both ends: the waiting period was shortened or eliminated while maximum potential duration was lengthened.

The benefit amount tended to rise automatically not only because of inflation but also because states had begun to adopt the "flexible maximum," that is, a provision that automatically raises the benefit maximum amount as total wages rise. In the late 1970s 36 states had this automatic device, whereas 30 years previously, when reserves were at their peak, none had it. Inflation also affected eligibility requirements, especially in states that expressed the requirement in terms of an absolute amount of wages. Under the impact of inflation, such a requirement became unrealistically low and admitted more claimants that had been planned for. All these changes on the benefit side of the program represented increased costs of which the states were not sufficiently aware in their planning. As a result reserves declined faster than had been foreseen.

To some extent the cause must be sought in limitations of the political process. Even when state adminstrators made the needs of the program known to state legislators, the latter sometimes neglected to take the recommended steps. There was at work the common political temptation to try to please all parties by increasing benefits and lowering taxes simultaneously. At work also was the more substantive political consideration that ample reserve funds tended to invite "raids" in the form of demands for more liberal benefits. This consideration always has been and probably always will be a major political obstacle to the maintenance of adequate reserves. Legislators also were influeneced by the consideration that a reserve fund immobilized dollars in Washington that might better be put to work in the state's economy.

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From the viewpoint of employers, the practice of borrowing interst free fund from the federal government made good economic sense. The employers in debtor states have had the costless use of billions of dollars. As a California actuarial firm said to the state agency, "What businessman would turn down an interest free loan?" One of the wiser steps of Congress was to begin charging interest on federal loans to the state funds.

Could the states have done better? It is certain they could. Considering the high reserves inherited from the war years, considering also the long prosperous period of the 1960s, when even the New England states had low benefit-cost ratios, considering finally the relatively small size of the unemployment insurance tax,[2] it seems clear that any and all of these states could have accumulated enough reserves in the 1960s to have seen through the unemployment of the 1970s. The continued high unemployment of the early 1980s, however, probably could not have been foreseen, nor would it have been practical in all states to have accumulated enough reserves to meet this very unusual demand. Some borrowing would have been inevitable, and desirable. The total amount borrowed, however, would have been much less if the states had been faithful to the guidelines provided by ICESA in 1959.

Would a federal system promoted solvency?

If the federal government, rather than the state governments, had been responsible for the solvency of the system would solvency have been better maintained? It is certain that, if pooled nationally, the same total reserve funds would have provided more protection against insolvency. Whether the same total reserve would have accumulated is questionable. Congress would have been under much the same political pressures as the states to keep taxes at the lowest possible level consistent with the vague notion of a "safe" reserve. Congress would have been more open to the possible use of deficit financing and hence would have been under less pressure to accumulate reserves against an unforeseen benefit drain.

The record of Congress in the financing of OASDHI reveals a much greater willingness to depart from "insurance" financing than the states have manifested. The record of Congress in financing the programs of extended benefits and of federal supplemental benefits shows the same tendency to pay benefits now and raise the necessary taxes later. The National Commission on Unemployment Compensation noted "the magnitude of the benefit costs resulting from the various federally enacted extensions during this period before sufficient reserves had been accumulated to pay them." If the federal government had been responsible for solvency and had in fact followed the policy of keeping reserves as low as possible, the final result probably would not have been substantially different. During the unexpectedly high unemployment of the 1970s the UI fund would have borrowed from general revenues, and the amount borrowed very well might have been greater.

The more the experience of the 1970s is analyzed, the less it seems to resemble a long term decline caused by basic weaknesses in the system and the more it resembles a short term difficulty from which the system has the innate health to recover. The lessons learned from the experience will make its repetition in the future less likely. The states gradually are including in their laws provisions that automatically guard state reserves. An increasing

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[2] The average unemployment insurance tax is less than a fifth of the other social insurance tax (Old Age, Survivors, Disability and Health Insurance), less than a twentieth of all fringe benefits, and a very tiny fraction of all production costs.

number of states are making use, for example, of the "common account," which automatically provides for the financing of noncharged and ineffectivley charged benefits. They also are making more use of a tax base that automatically rises with total covered wages. In general the states are making less use of absolute amounts and more use of ratios as instruments of control. The experience of the program indicates that provisions that perform a clearly useful function, after being introduced by a few leaders, tend to spread to the rest of the states. On the whole solvency is likely to be better protected in the future than in the past, partly because of the recent jolting experience.

Cost sharing

The requirement that every state meet its own Unemployment Insurance costs has resulted in a very unequal distribution of the total cost burden. The long run cost rate of Rhode Island, for example, has been about four times that of Texas. Although these two happen to be the smallest and largest of the states, there has been little correlation between size of state and cost rate; large and small states are about equally represented among the high cost and low cost states. Geographically, however, there has been a marked concentration of high cost states in the north: of the 25 states with the highest cost rates, only five are in the south or southwest.

There have been many proposals to achieve a greater equality of cost through some form of federal subsidy. Although they have usually borne the title of reinsurance, the proposals were really cost equalization.[3] Cost equalization was discussed by the Committee on Economic Security in 1934, and thereafter plans for cost equalization surfaced repeatedly — for example, in 1944 (S. 1730), in 1950 (H.R. 8059), in 1952 (H.R. 6954), in 1959 (H.R. 3547), in 1965 (H.R. 8282), and in 1979 (H.R. 3937). Some of these proposals occasioned major congressional debates, especially H.R. 8282 in 1965; but in the course of 50 years the principle never was breached that because Unemployment Insurance is an extension of the wage system and a regular cost of doing business, each state is responsible for its own cost.

Considering how frequently cost sharing has been proposed, it is surprising how undeveloped are the arguments put forward to justify the proposal. One of the most frequent arguments simply has been the statement that the states with high costs have not been "responsible" for these costs and hence should not be required to meet the costs. Unemployment is similar to a natural disaster in that it is beyond the control of the states. The state of Washington has more unemployment than the state of Texas because of its climate and its seasonal industries. No matter how hard it tried, Washington could not bring its unemployment down to the low level that Texas enjoys. Michigan always will have a high unemployment rate because it is in the nature of the auto industry to produce more than average unemployment. If the nation wants automobiles, as it does, then the nation's consumers, whose fluctuating demand causes the unemployment that marks auto production, should bear part of the cost of the unemployment. The state that assumes the function of producing the autos should not be burdened with the total cost.[4]

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[3] Where the reason for reinsurance is the unforeseen nature of the burden, the reason for cost equalization is the excessive size of the burden, even though foreseen. The most frequently used definition of "excessive" has been a cost rate above 2 percent of total wages.

[4] For example: "Cyclical fluctuations in state unemployment rates are national in origin. It is irrational and inequitable to require states to bear the cost of programs that are not under their control. In the short run, the responsibility for laying off an auto worker in Michigan lies more with the consumer who does not buy a car

The argument limps badly. Unemployment differs basically from natural disasters. Unemployment benefits are among the regular costs of doing business. They are about as predictable as most other business costs and are as traceable to particular economic activities. A firm engaged in outside construction work expects to experience more unemployment than one engaged in inside construction and very much more than a firm engaged in the banking business. These differential costs are translated into differential prices of various kinds by the normal workings of the competitive market.

Although it is true that the poeple in Georgia who wish to have the use of automobiles manufactured in Michigan should be ready to share in the cost of the unemployment benefits necessarily connected with the production of automobiles, it does not follow that this sharing may best be achieved by having the employers of Georgia pay a subsidy to the employers of Michigan. Normally the purchasers of automobiles find the cost included in the price they have to pay for automobiles. This is the customary way of allowing the market to allocate resources. Michigan, not Georgia, is responsible for the costs of producing automobiles.

It is useful to note an ambiguity in the term "responsible." When a firm is said to be responsible for its own unemployment, we do not mean that the firm is in some way at fault and that the economic agent, firm or state, could and should have done something differently so as to avoid unemployment. The economic agent is responsible for unemployment only in the sense of paying for it as a regular cost of engaging in that kind of economic activity. The cost is brought home to the "responsible" party only in the sense that this cost, just like wages and other business costs, is allocated to its source and thus becomes a part of the price mechanism. Whether the economic agent could or could not have avoided the unemployment is irrelevant to the economic meaning of "responsibility."

Sometimes the argument is used that states should not be held responsible for unemployment that is traceable to "national" causes. A leading example is the unemployment resulting from actions of Congress or the president, such as the closing of military installations or the permitting of competition by foreign products. Such unemployment should not be the burden of a few particular states but should be financed, at least in part, by a tax levied on the total economy. Another example is cyclical unemployment, which by definition is a broad, national phenomenon with causes outside the boundaries of any particular state.

This line of argument is subject to severe limitations. The notion of "national cause" is hopelessly vague. Most of the legislation pouring out of Congress and most of the administrative regulations pouring from the executive agencies have an economic impact, and they are all national causes. No principle is available to identify national causes that do and do not absolve the states from responsibility for any resulting unemployment. When a federal installation is closed some states are especially affected, but these are usually the same states that lobbied vigorously to obtain the installation in the first place and profited from it as long as it was in operation. There is no obvious principle by which to absolve such states from the cost of the resulting unemployment benefits.

Cyclical unemployment not unique

Cyclical unemployment is as clearly linked with particular economic activities as are other kinds of unemployment. The cyclically unemployed are not a unique group. Their

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wherever that consumer may be — than with the firm which lays off that worker." Staff report, Northeast-Midwest Institute, August 1978, p. vi.

unemployment stems from the same complex mixture of personal and impersonal causes as unemployment in general. A business recession is merely a time when these causes are more operative than usual, that is, when a greater number of firms than usual are cutting back on economic activity.

The crucial point is that some kinds of economic activity are predictably more subject than others to cyclical swings. Firms engaged in such activities normally take this characteristic into account and plan accordingly. If the losses of cyclically sensitive industries are greater on the downswing, their profits are generally greater on the upswing. The cost of unemployment benefits is only a part, a small part, of the cyclical costs a firm expects to meet in its normal operations. Although somewhat less predictable than other kinds of unemployment benefits, and somewhat larger in amount, benefits paid under the provision of the regular Unemployment Insurance System during a recession belong among the regular costs of doing business.

Potentially the strongest argument for some cost sharing looks to the Unemployment Insurance program itself and the possible effect of tax burdens on benefit liberality. If the burden of high unemployment keeps some states from otherwise liberalizing their benefit program, cost sharing might remove this limiting force. All the cost sharing proposals of the past have worked in terms of unemployment rates: states with higher than average unemployment rates were to be given some assistance in paying unemployment benefits — with the expectation that the financial assistance would result in a better program.

In this argument "better" is assumed to mean "more liberal." Obviously there must be some limit to liberality beyond which the more liberal is not the better. The assumption may be granted, however, for the sake of the argument. It permits us to discuss the issue of cost sharing in terms of its probable effect on program liberality.

The argument for this possible effect can be made most cogently in the case of states that are below average in liberality. Using a liberality index based on cost rates corrected for the factor of unemployment, it is possible to identify 29 states, with 55 percent of covered employment, which may be classified as below average in liberality during the period under consideration, the decade of the 1970s, which was the period of greatest financial stringency.

This group may be further divided into those with below average unemployment rates (Groups X) and those with above average unemployment rates (Group Y). Group X comprises 18 states with about 36 percent of covered employment and predominately located in the south and west (there are no states from the northeast and only four from the midwest). It is particularly difficult to establish a casual relationship between the degree of liberality and the burden of unemployment in the case of Group X states. Since these states have below average unemployment, there is no immediately evident reason for affirming that unemployment has kept them below the average in liberality. In any case since these states are below average in unemployment, they would not draw significant amounts of subsidy from any cost sharing plan that might be established. For both reasons Group X states do not provide clear evidence of the need for cost sharing.[5]

Group Y comprises 11 states, with about 19 percent of covered employment, which combine the two characteristics of below average liberality and above average unemployment.

Moreover, five of these states (Colorado, South Carolina, South Dakota, Tennessee and Wyoming) are so close to the average in liberality that a very slight change would raise them above average.

They are: Alaska, Arkansas, Idaho, Maine, Michigan, New Mexico, New York, Oregon, Puerto Rico, Washington and West Virginia.

Because they are above average in unemployment they may receive significant help from a cost sharing program; because they are below average in liberality, they may use the help to liberalize their programs. These are the states that provide the chief argument for cost sharing, for here, if anywhere, the burden of unemployment may be the cause of a low level of liberality. If the argument for cost sharing cannot be made effectively in the case of these states, it probably cannot be made anywhere.

Many factors determine liberality

Four states (Arkansas, Idaho, New Mexico and West Virginia) had unemployment rates only slightly in excess of the national average and would have received very small grants, if any, if a cost sharing plan had been in operation during the decade of the 1970s. The smaller the grant, the less likely it is to have a significant effect on the state receiving it. Cost must compete with other, especially political, factors in determining the liberality of a state program. A small difference in cost is likely to be lost among other factors.

Of the remaining seven, the significance of New York must be largely discounted. During this period the chief reason that New York was not more liberal does not relate to the cost of the program. New York labor and management were battling over experience rating, and the liberality of the program was a victim of that struggle. The chief reason for the less than average liberality of the New York program was the low maximum benefit in that state. The New York senate, at the behest of management, was unwilling to raise the maximum benefit until experience rating has been restored permanently. The New York assembly, at the behest of labor, refused to accept this condition. Any grant that New York could have received in the decade could not have changed the outcome of that political contest. On the other hand, without this stalemate, the maximum benefit would have been raised, and any increase in it would have put New York over the average in liberality, for it was only slightly below the average.

Of the six remaining states, two justly can be regarded as special cases. Alaska was below average in liberality primarily because it had a low maximum benefit, but this low maximum was the result of a federal regulation. Half of Alaska's claimants leave the state each winter and draw their benefits while living elsewhere. Because Alaska's wages and all other prices are so much higher than those in other states, Alaska would like to distinguish between its two groups of claimants and pay higher benefits to claimants who remain in Alaska. Since this was forbidden by federal regulation, Alaska paid all claimants benefits that were suitable for the migrants. (If the state paid the migrants a benefit that equaled half their Alaskan wage, their benefit would equal or exceed available wages in the lower 48 states.) The solution here was not to pay grants to Alaska but to lift the federal regulation. The recent subsidiaries paid by Alaskan government to all its citizens and the remission of their taxes should be sufficient indication that state taxes are not the primary problem here.

Puerto Rico is the other exception case. Its economy is completely dependent on that of the United States, and its Unemployment Insurance program is very different from the programs in the continental United States. In nearly every respect it must be considered separately from the other states.

Maine, Michigan, Oregon and Washington, with 7.12 percent of covered employment, thus represent the only clear examples of states where above average unemployment

might be the cause of below average liberality and where a subsidy might result in increased liberality. Thus the argument for cost sharing applies to only a small part of the system and even there only as a possibility.

It is relevant to note that Maine is the only one of these four states that is below average in per capita income. Moreover, the case of Michigan is weakened by two considerations. Michigan is not a poor state but ranks well above the average in per capita income. Also, the auto industry and subsidiaries explain the largest part of Michigan's above average unemployment, and these industries in particular have been the most prosperous. They pay their workers well above the average of all workers. Even more to the point, most of them provide supplemental unemployment benefits that increase the protection of the regular program in both amount and duration of benefits. If Michigan employers can afford the cost of this additional protection, they should be able to afford the cost of regular unemployment benfits. Certainly employers in states that cannot afford these higher wages and supplemental benefits should not be asked to pay the cost of Michigan firms.

A state may be considered unable to pay its own Unemployment Insurance costs not only because its burden is above average but also because its financial means are below average. A state's per capita income may be taken as a rough measure of its financial means. The strongest argument for cost sharing can be made in the case of states that have three characteristics: (1) They are below average in liberality; hence there is probably room for increased liberality. (2) They are above average in unemployment; hence they may expect to receive some significant subsidy from a cost sharing plan. (3) They are below average in per capita income; hence they may need some assistance from more fortunate states. Only five states exhibited these three characteristics during the decade of the 1970s: Arkansas, Idaho, Maine, New Mexico and West Virginia. Collectively they account for only 2.7 percent of all covered employment. All the other states were already above average in liberality or were below average in unemployment or were above average in per capita income. Finally, of these five states, only one (Maine) had an unemployment rate notably above the average.

Conclusion

For 40 years the record of the states in maintaining solvency was excellent. During the past 10 years their record has been ragged. Too many states had to borrow too many millions, even billions, of dollars. Although they are repaying their debts some change in the system would seem to be called for by way of safeguarding the future. Two alternatives offer themselves. One is to shift responsibility from the individual states to the federal government. Currently that alternative has little appeal. The inability of Congress to deal with the ballooning national deficit, an impotence so patent as to be embarrassing, leads rather to the opposite conclusion. UI has been fortunate that long run responsibility for financing has not been in the hands of Congress.

The other alternative is more attractive. With the advice, and perhaps some pressure, from the Department of Labor, the states should adopt techniques that will safeguard the solvency of their reserve funds — techniques that in the course of 50 years of experience have been established as trustworthy.

The distribution of UI taxes has been very uneven among the states. There is little evidence, however, that any state has been unequal to its burden. States are economic entities in competition with one another. Hence, other things being equal, each state is expected to meet its own costs. In a society like ours, which uses the competitive market and the price system as its chief method for the allocation of resources among its citizens,

the burden of proof rests on any proposal to have the federal government intervene in the competition between the states and to require the employers of one state to subsidize the employers of another. The difficulty of developing such proof no doubt accounts for its scarcity.

During the past five years, financial pressures have caused some states to review and tighten the provisions of their program — chiefly eligibility, disqualification and duration provisions. These legislative changes have contributed (along with some basic changes in the composition of the labor force) to a long term decline in the proportion that UI beneficiaries make of all the unemployed. This declining proportion presents a problem calling for attention and perhaps action. Action may take one of two forms: either the UI program may be changed so as to accommodate the unemployed presently excluded, or some new program may be devised. Such a new program would differ from Unemployment Insurance in its conditions of eligibility, in the kind of benefits and services (especially services) it would provide, and certainly in the source of its finances.

Given the unique importance of UI's clientele (the members of the work force who normally are employed), given also the proved ability of UI to care for this clientele, we probably shall be following the wiser path if we decide to leave the present UI system essentially unchanged and care for a different group of the unemployed with a different kind of program.

Monetary, nonmonetary and benefit formulae

by Gerry Gilmore

The Unemployment Insurance System, as we know it today, first appeared as part of the Social Security System in 1935. The concept of helping the unemployed during depressed economic times, however, can be traced throughout the history of the Western World. One of the earliest mentions of assistance to the unemployed was in ancient Rome, in the second century, B.C., when a family of nobles, called the Gracchi, gave returning, unemployed soldiers small pieces of land and paid them money for building roads.

Later in 44 B.C., Julius Caesar, picking up on the Gracchis' idea, distributed grain to unemployed veterans. In later centuries craft guilds and then labor organizations began to help their unemployed members.

More recently, at the end of the 19th century, Unemployment Insurance plans increasingly appeared in this country. They were generally of three kinds: trade union plans, which grew out of the union tradition of helping their unemployed members; union–employer negotiated plans and employer initiated plans. By the end of the 1920s, 19 countries in Europe had nationwide Unemployment Insurance plans. There was much talk here that something more should be done for the many who weren't part of a plan. In the 1930s, when many of the voluntary plans began to collapse from the weight of unemployment in the great depression, the nation was finally moved to do something about the unemployed.

In the vigorous dialogue among scholars, politicians, labor and business leaders that attended the formation of the Unemployment Insurance System, there was much discussion

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about who should get benefits, what eligibility requirements should be imposed on them and how much they should receive. Concern was evident that the program not be preceived as a relief program, but rather as an insurance program offering temporary help to those who were firmly attached to the labor force but through no fault of their own had become unemployed.

Congress set few restrictions on the receipt of benefits, leaving to the states the decisions of whom to pay and how much. Today all state UI laws measure a worker's entitlement to benefits by his work experience during a recent period prior to his becoming unemployed. It is called the base period. For most states the base period is 12 months, but 16 states attempted to collect weeks of work to measure attachment, and indeed a few still do, but most shifted to collecting quarterly wages in 1937 when the Internal Revenue Service began to require quarterly reports for Social Security purposes. Most states require that the reports be sent in quarterly, though 12 states obtain them on a request basis. Of these, three now are changing to making their submittal a requirement.

Since the beginning of the system all states have had a minimum earnings requirement that a worker must have in his base period to be eligible for benefits. Originally the minimum ranged from $100-$300. Now it ranges from (omitting Hawaii, Puerto Rico and the Virgin Islands) $300 in Louisiana to $3,000 in Oklahoma. The purpose of the minimum is to ensure substantial attachment to the work force. It is clear that states differ greatly in their definition of "substantial."

Eligibility requirements vary among states

Initially all states required a waiting period before paying UI benefits. Originally the Social Security Board recommended a two week waiting period in any 13 weeks of unemployment or, alternatively, a four week waiting period in any 52 weeks of unemployment. It was felt that a waiting period would make benefits payable over a longer duration of time. Most states felt that two weeks would be required to process a claim, and 30 states opted for that waiting period. Nineteen states chose a three week period, and two chose four weeks. Automation has, of course, eased the difficulty of processing a claim. Today 10 states have no waiting period for total unemployment, and no state has more than a one week period. Six states pay benefits for the waiting week under certain conditions, and one is planning to repeal the waiting week.

Originally only one jurisdiction, the District of Columbia, paid dependent benefits. Over the years more states included dependent benefits until now 13 states pay them. All states have limitations on the weekly allowances, and several pay varying amounts depending on the claimant's weekly benefit amount. The allowance for one dependent ranges from a low of $1 in five states (all five have a range for each dependent varying by the claimant's weekly benefit amount) to a high of $76 in Ohio. All states have a limitation on dependent allowances for all dependents as well, from a low of $8 in Pennsylvania to a high of $98 in Massachusetts.

Though all states require that workers demonstrate their attachment to the work force by having wages or weeks of work in the base period, all, as well, insist on other requirements to be eligible for benefits. Initially federal law did not address eligibility and disqualification provisions in the Unemployment Insurance System, except to state three conditions under which compensation could not be denied for refusing a job; "if the position offered is vacant due directly to a strike, lock out or other labor dispute; if the wages, hours or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality; if as a condition

of being employed the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor organizaiton."

They addressed what states could not establish as eligibility requirements rather than what was required of workers to become eligible.

From the beginning all states have required that workers be able to work and be available for work. Most accept registration for work at a Job Service office as evidence that claimants meet these criteria. But state provisions vary widely concerning other measures of availability for work, voluntarily quitting a job, discharge for misconduct, refusal of suitable work, involvement in a labor dispute and fraudulent misrepresentation too obtain benefits. These are the most prevalent reasons for disqualifications.

Two other reasons are disqualification of special groups and disqualifying income. For a time all states disqualified a woman because of pregnancy, and most extended the disqualification for specific periods of time before and after the childbirth, although there was little uniformity to the time. Federal law changed this in 1970. Now pregnancy is treated like any other sickness or disability.

Disqualifications exist basically to prevent payment to workers for other than economic reasons. The UI System was put in place to assist workers who are temporarily unemployed due to no fault of their own, and most states have attempted to adhere to this philosophy.

Some states disqualify for a specific period of time and that can vary by different disqualification reasons. These disqualifications range from 1-52 weeks depending on the severity of the violation. Most states disqualify for the remainder of the period of unempioyment plus a reearnings requirement. That means that the disqualified worker must get another job, must work a specific number of weeks and then must be legitimately laid off from that job to overcome the disqualification and again be eligible for benefits. In the former case the theory is that after a sufficient time the disqualification is no longer the cause of unemployment.

Like eligibility provisions, formulae for computing benefit amounts reflect a lack of central direction from federal law. They vary considerably among states. They do include common themes that grow out of early thinking on Unemployment Insurance.

In early studies it was thought that the wage replacement rate should be appreciably less than what the worker earned so that he would have an incentive to return to work. It should replace only nondeferrable expenses, thought to be food, rent, utilities and medical expenses. Since then some have added grooming and transportation, two essentials in finding a job.

Douglas study suggests benefit ranges

In a 1932 study Paul Douglas, then a professor of economics at the University of Chicago and later to serve as U.S. Senator from Illinois, suggested that the replacement rate be graduated downward from 60 percent to 30 percent with lower paid workers receiving a higher proportionate replacement. His rationale was that lower paid workers were more likely to be in need and less likely to have savings to rely on during their unemployment. He suggested a benefit table ranging from $5-$15 divided into 10 earnings categories. Recognizing that some would oppose the idea of giving the poorer workers proportionately more benefits, he suggested an alternative 50 percent replacement rate for all with benefits ranging from $4.25-$21.00 divided into eight earning categories. He felt strongly that benefits should show some relationship to past earnings.

Today his and other scholars' thinking is apparent in all state benefit formulae. Benefit amounts vary greatly among states but all reflect past wages within certain minimum and

maximum limits. Minimum benefits range from a low of $5 in Hawaii to a high of $54 in Virginia. Maximums range from a low of $84 in Indiana (for a worker with no dependents) of a high of $225 in West Virginia.

When states began collecting quarterly reports, the Social Security Board advised using the quarter of highest earnings in the base period to compute the weekly benefit amount. They suggested that using the fraction of 1/26th of quarterly earnings to determine the weekly benefit amount would be the same as replacing 50 percent of the weekly wage. They advised, though, that there would be some unemployment or short working weeks even in the high quarter, and thus states might want to use a higher fraction. Most states followed the recommendation. Some adopted a multiple fraction that whereby lower paid workers benefits are determined at higher fraction than are higher paid workers.

Today 37 states use the high quarter formula. Of these only seven use the 1/26th fraction. Thirteen states have adjusted the fraction they use to account for some unemployment in the high quarter. They range from 1/26 to 1/25, with eight of them using the lower fraction. Two states use a percentage of high quarter earnings to compute the benefit amount. Colorado uses 60 percent and South Carolina 50 percent.

Some states use a range. In these the fraction varies, giving higher benefits to lower paid workers. The highest of these, 1/11, is in Puerto Rico where it is possible that weekly benefits can exceed weekly earnings. The lowest, 1/33, is in California where 39 percent of weekly wage is replaced for higher paid workers.

Ten states use the entire base period instead of the high quarter to compute the weekly benefit amount. In these the benefit amount ranges from 50-67 percent of average weekly wage computed from annual earnings.

Six states use a percentage of annual wages to compute the weekly benefit amount. These range from one percent in West Virginia to 3.8 percent in Alaska. In these states it is believed that annual wages rather than high quarter wages more nearly reflect the worker's normal wage.

Initially the duration of benefits that could be provided within the recommended tax structure was very conservatively estimated. It was thought, too, that eight to 15 weeks could be provided depending on the length of the waiting period.

States were more optimistic and provided longer periods of duration. Four states established duration at 20 weeks, one at 18 weeks, 28 at 16 weeks and three at 12 weeks. As it became apparent that the system could afford longer durations, and that there was a need for longer durations, states began to extend the maximum duration that a worker could draw benefits. Most settled on 26 weeks, the duration that had been established in most European unemployment insurance systems.

Today most states have a 26 week maximum duration period. Washington and Massachusetts have 30 week periods. West Virginia has a 28 week period, and Puerto Rico has a 20 week period.

Ten states have uniform duration periods. In those states all eligible claimants can draw weekly benefits for the maximum duration. It is believed that all unemployed workers need potentially the same amount of time to find new employment.

The remaining states have variable duration, with as few as four weeks in Georgia. These states assign potential duration to unemployed workers according to their work attachment in the base peroid, generally measured by their earnings.

In 1966 after most states had extended duration to at least 26 weeks, authors William Haber of the University of Michigan and Merrill Murray of the W.E. Upjohn Institute made an interesting observation on the duration of benefits in their book *Unemployment Insurance in the American Economy:* "The duration of 'regular' unemployment benefits

has been liberalized more than any other feature of Unemployment Insurance, but there is still much room for improvement. The state formulae for limiting duration should also be liberalized. Too many workers are getting too few benefits in too many states."

Of course, since then a permanent federal extended benefit program and federal supplemental programs have been introduced that extend duration during periods of high unemployment. Both of these programs are undergoing review in Congress currently with a view toward making duration longer.

For 50 years the Unemployment Insurance System has well served the American economy, its workers and its employers. As the character of the labor force changes, as it has quite dramatically in the last few decades, some of its original concepts may have to be rethought and some of its goals redirected. It is, however, a vital part of our working lives and will most likely remain a stabilizing effect in future years.

The financing foundation of UI

by James W. Jackson

The source of funds for the payment of unemployment benefits as originally enacted by the Social Security Act was employer payroll taxes. The original Act provided for a payroll tax of 3 percent of total wages on subject employers. The Act provided that employers subject to the federal tax would receive credit for contributions paid under an approved state Unemployment Insurance law. The maximum credit was 90 percent of the federal tax, or an amount equal to 2.7 percent of taxable wages.

In addition, employers contributing under an approved state law are entitled to an "additional tax credit." Under the additional credit allowance an employer can take the full 2.7 percent credit even though his states Unemployment Insurance tax rate is less, provided it was reduced below that level through experience rating. Simply, experience rating is how little a company's employees collect benefits. Taxes collected under the state Unemployment Insurance law would be used solely for the payment of benefits, while the net federal tax would be used to pay the costs of administering the program.

The tax credit concept was adopted to encourage states to enact Unemployment Insurance laws, which all states had by the end of 1937. The American system of Unemployment Insurance is unique because of its federal-state concept. An exclusively federal system was considerd but rejected for a number of reasons, one of which was the fear that a federal system might be declared unconstitutional.

In 1939, the taxing provisions of the Social Security Act were repealed and reenacted as the Federal Unemployment Tax Act of the Internal Revenue Code. Over the years

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there have been numerous amendments to the federal Unemployment Insurance laws affecting employer coverage, tax rates, the taxable wage base and federal requirements. However, the basic tax credit system has remained intact. It is of interest to note that taxes were collected two years prior to the initial payment of benefits, thus assuring adequate reserves for UI trust funds (where each state's contributions are deposited until payment is necessary) when the system began.

Original coverage limitations

As originally enacted, coverage was limited to employers who employed eight or more workers for 20 or more weeks a year. Effective Jan. 1, 1956, employers of four or more for 20 or more weeks were included for coverage under the system. On Jan. 1, 1972, coverage further was extended to include employers with one or more employees for 20 weeks or a quarterly payroll of $1,500. Nonprofit organizations came under coverage also if they had four or more employees. In 1976, coverage was extended to employees of state and local government, to household workers who are paid $1,000 or more in a calendar quarter and to agricultural employers if they employ 10 or more workers for 20 or more weeks or pay $20,000 or more in wages in a calendar quarter.

Federal government workers were covered in 1954. Railroad workers are covered under a separate federal system, which was effective Jan. 1, 1939. Excess funds originally collected by states from railroad employers under coverage by the state were transferred to the federal system.

It is estimated that 97 percent of workers subject to the risk of unemployment are covered under the Unemployment Insurance system. Although coverage is mandated in federal law, states are free to extend coverage to workers not mandated under federal requirements — for example, some states require coverage of one or more workers at any time in their state laws. Which employers are subject to coverage under state laws depends on the particular state being considered. Generally speaking if an employer is subject to coverage under the Federal Unemployment Tax Act (FUTA), he would be covered under the state law. Some states do not have this as a requirement. However, if coverage is required by FUTA and not by state law, the employer must pay the full FUTA tax.

Exclusion from coverage, depending on specific provisions in state laws, may fall in the following groups:

> Insurance and real estate agents; casual labor not in the course of the employer's business; part time service for nonprofit organizations; elected officials; legislators and members of the judiciary; members of the National Guard and Air National Guard; temporary emergency employees; policymaking and advisory positions; spouses in the employ of their husband or wife; children under age 21; and father or mother in the employ of their child.

In recent periods attempts at further exclusions have been made. Defining certain groups as being independent contractors has been the subject of federal legislative bills to exclude them from coverage requirements. Thus far Congress has failed to act in this area. Over the history of the system the trend has been to extend coverage requirements. Whether or not the pendulum will now swing in the other direction is unknown.

The wage base changed many times

Total wages of covered employers were subject to tax when the Social Security Act became effective. The Unemployment Insurance taxable wage base has been changed by

federal law many times over the history of the system; going from total wages, to the first $3,000 of wages, to the first $4,200, to the first $6,000, and now to the first $7,000 of wages paid covered workers. Thirty-two states now have wage bases greater than the federal requirement. These range from $7,100 in Conneticut to $21,400 in Alaska. Puerto Rico's taxable wages are total wages paid. In some states the taxable wage base changes on the basis of a percentage of average total wages paid in their state each year.

The wage base originally was changed because of a change in FICA (the Social Security contribution), and both were set at $3,000., Over the years, even though FICA wages have constantly increased, the FUTA wage base has remained fairly low. At present the $7,000 base represents the approximate amount that a person making the federal minimum wage would receive even though benefits are based on total wages in most states. Some would say that the different values placed on the wage base, to a certain extent, limit the understanding that the public could have of the relative costs being incurred by the UI system. Tax rate applying to a relatively low wage base would necessarily have to be high as opposed to lower rate on a relatively higher wage base if both were used to bring back the same costs being experienced. In order to understand the costs being experienced, benefits paid as a percentage of total wages would have to be used since taxable wage bases vary so much between states.

Perhaps it should be recognized that the wage base has two separate functions. In one case it is used with the FUTA tax rates to fund the costs of administration, both federal and state; and in the other situation its use is in state formulae, where along with tax rates it determines the funding of the costs of benefits. Since costs of benefits vary greatly among the states, variation has taken place in what should be the amount of the wage base for the state.

Perhaps if the wage base for all states were the same as Alaska ($21,400), with FUTA wage base being the same, amounts collected for state and federal administration would be greater than the amounts being appropriated for this cost. How much the value of the wage base should be above the federal minimum of $7,000 is a decision left up to the states. The states are the ones responsible for paying the benefits required by their particular law, so they must have the freedom to alter their financing formulae to fit the needs of their particular state.

Some states are reluctant to change their wages bases above the federal minimum required due to their belief that a higher wage base would appear to make them less competitive with other states. In addition they feel it is less of a burden for their employers if both wage bases (federal and state) are the same value. Regardless of which way a person would view the wage base, it, along with the tax rates used, is needed to raise the appropriate amount of revenue for financing the benefits paid.

It has happened in the past that when the federal wage base was raised to a higher minimum at least one state, feeling that additional revenues were not needed, lowered its tax rate so as to only take in the amount of revenue it felt was needed. In looking at the future, perhaps the federal minimum wage base only will be changed when federal authorities perceive that a change is appropriate for financing state and federal administrative cost, and states who would want a change in order to bring in more revenue for proper financing of their benefit costs will have to bear the responsibility of raising their wage bases themselves. Evidently 32 states have already, to a certain extent, accepted this responsibility themselves and perhaps wonder why other states do not do the same, especially since some are now in a deficit condition.

Experience rating determines tax rates

The variation of tax rates in relation to individual employer experience with unemployment is known as experience rating. States are allowed to reduce tax rates of their employers below the 2.7 percent required by federal law if they do so on the basis of experience rating. Initially the UI system was structured on the assumption that long term cost of the system would be approximately 3 percent of total wages. Costs by experience have been less than this amount. Experience rating has been a method used to reduce total revenue and to reward those employers whose costs are less than others who have greater experience with unemployment.

In setting up experience rating, states have used differing systems to measure an employer's experience with unemployment. Thirty-two states use a reserve ratio formula, which is essentially cost accounting. A record is kept of the employer's payroll, his contributions and the benefits paid his workers. The benefits are subtracted from the contributions and the resulting balance is divided by the payroll to determine the size of the balance in terms of the potential liability for benefits inherent in wage payments. These balances are carried forward each year but may be limited to certain time frames in particular states. The employer must accumulate and maintain a specified reserve before his rate is reduced. Then rates are assigned according to a schedule of rates for specified ranges of reserve ratios, the higher the ratio, the lower the rate. The formula is designed so that no employer will be granted a rate reduction unless over the years he contributes more to the fund than his workers draw in benefits.

Some states use the benefit ratio formula, which uses benefits as the measure of experience but eliminates contributions from the formula and relates benefits directly to payrolls. The ratio of benefits to payrolls is the index for rate variation. The theory is that if each employer pays a rate that approximates his benefit ratio the program will be adequately funded. Unlike the reserve ratio, the benefit ratio system is geared to short term experience, usually three years, but may vary up to five years depending on the particular state's law.

Other experience rating systems are the benefit wage ratio formula and the payroll variation plan. At present, all states and jurisdictions, except Puerto Rico, have some form of experience rating.

Some states tighten laws

In addition to tax rates on the basis of experience rating, other rates are added or applied based on the size of the amount of reserves in the trust funds. Also, in states where not all benefits are charged to the experience rated accounts of employers, some methods, such as a replenishment ratio, is used in an effort to recoup these amounts.

Leakages can occur as a result of employers going out of business, where charges exist to an employer's account above the states' legislated maximum rate, where extended benefits may not be charged, where some portion of a combined wage claim may not be charged to an employer's account, where bankruptcies exist, where overpayments are not collected, etc. Some states have tightened up their laws in these areas to now require recoupment of the leakages that they are able to identify. In doing so they have attempted to correct the deficiencies in their system that these leakages create.

Interest earned by the trust fund is a source that can offset some of the leakages if one assumes a positive balance trust fund. A state with supposedly adequate reserves

of one and one-half of their high costs could in recent years have earned a considerable amount of interest, which in turn helps to offset leakages that may be occurring.

Seemingly, with state trust funds for the payment of benefits facing greater and greater strains due to economic cycles, more and more tightening up for financing systems is taking place.

Generally states have a measure in their laws that comes into play as the trust fund fluctuates between relatively low balances or relatively high balances. In recent history we have seen things labeled as a solvency rate tax, a deficit tax, surplus ratio, adjustment ratio, social tax, stabilization tax, additional surcharge, solvency contribution, solvency surcharge and state adjustment factor. All these terms are aimed at increasing revenue or reducing it. As trust funds are depleted, the measures trigger in additional tax rates; as the fund expands to levels above certain amount tax rate reductions are applied.

The measure used may be a fixed dollar amount, a percentage of the state's payrolls — either taxable or total — a percentage of average benefit payments over a defined number of years, etc. Some of these measures are such as to cause the taxing system to response — either to bring in more revenue or to decrease it in a seemingly timely manner — while others are such that they either have not triggered tax revenue increases quick enough or large enough to keep trusts funds from becoming depleted. Recently some of these measures have been changed to bring in lower amounts over a longer period of time to cushion the effect of large tax increases over a short period of time such as during a recession. When this occurs it stretches out the period of debt repayment and causes more interest to accrue.

States face reserves problem

Part of the problem that states face is how much should their reserves be in line with the liabilities of the system? It seems that fewer and fewer states are able to withstand recessions before another one hits. At the same time, when interest rates are relatively high, employers feel that the opportunity cost of capital is such that a very small trust fund should be maintained. This seems counter to the supposed needs of the system to build up reserves so as to be able to withstand the next recession. When states have depleted their trust funds and are having to raise revenues during the depths of a recession it seems to be like kicking a fellow when he is down. Not only is he faced with higher tax rates, but also he must come up with monies to pay interest on the loan that has to be made. But then, is the cost of having a large trust fund such that if the employer had the money rather than the government would the country as a whole be better off?

The question probably only can be answered by an individual employer — whether "he" is better off under this condition. Is it better for him to pay his tax and the interest, or is it better to have sums tied up in reserves that he cannot use? Collectively it seems a trend is occurring where state agencies administering UI payments will be allowed funds for cash flow purposes for a relatively low level of unemployment benefit payments but, when a greater amount is needed, borrowed funds will be obtained and appropriate interest on these amounts paid. Whether or not this is an appropriate course for the nation this writer does not know, but it does seem to reflect a change in the pattern of prior thinking where reserves were maintained against the day when they would be needed. In today's world of expanding deficits, can or should we expect anything different?

Another seeming trend also has occurred since the system began, that is the difference between long range and short range planning in business operations, which affects the thinking relative to the amount of reserves allowed in state trust funds. Business, it seems,

is taking a short range view today — the immediate effect of any change and its effect on short range profit. If costs can be postponed to some later period where perhaps they can be met by inflated or cheaper dollars, postponement seems to be the course of action. Political entities can postpone increases that may be needed until another administration takes over, or delay and postpone tax increases already legally mandated and shift this to next administration. In the absense of any solvency requirements in federal law such actions have been and probably will continue to be used.

Someone recently asked the question, "Doesn't the government require a certain amount of reserves from insurance companies before they are allowed to do business or to continue in business? If they do this, why should the Unemployment Insurance system be different?" This writer does not have a good answer to this question, but feels that funds still should be set aside during the good times so that they are available for the bad times without having to increase the tax rates during the bad times. This writer is evidently out of step with today's world.

Financing the administration of the UI program

by Gerald E. Dunn and Kathleen Griffin

For almost 50 years the nationwide Unemployment Insurance System has enabled temporarily unemployed workers who are actively seeking new employment to meet nondeferrable expenses without resorting to welfare and without having to meet a means test.

This federal-state system was created in the Social Security Act of 1935. Its provisions encouraged each state to enact its own program consistent with federal conformity provisions within areas where uniformity is considered essential while giving states latitude in other conditions of coverage or eligibility. As a result, while conforming to the basic federal requirements, the laws of each state establish different administrative, eligibility, coverage and benefit level and duration standards. Each state administers its own program.

Within the federal-state arrangement each partner assumes important responsibilities. While the program costs — the funds for paying benefits to unemployed workers — are raised by state taxes on covered employers, the costs of administering each state's program are met from revenues collected by federal government under the Federal Unemployment Tax Act (FUTA). Although the receipts from this separate tax on employers go into a special fund, the FUTA receipts are appropriated by Congress as part of the budget process. Within these appropriation levels, funds are apportioned to the states by the U.S. Department of Labor under mechanisms based on expected workloads

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and predetermined time factors within which identifiable units of workloads are expected to be accomplished.[1]

There are three distinct elements to these individual state allocations for meeting the administrative costs of each state's UI program:

"Base" funding for "permanent" staff;

"Additional contingency" funding for temporary, seasonal employees to adapt to variations in workload;

Funds for nonpersonal services costs (NPS).

The funding mechanism

The funding mechanism for the UI program is unique in governmental operations. The two most critical elements are the workload estimates and the minutes allowed to process each unit of workload (MPU). The dollar allocations derive from the translation of the estimated workloads time the average MPU into staff years. When multiplied by an average salary cost, this computation produces the dollar allocations for personal services.

Workloads for the budget period are estimated several months in advance of the 12-month fiscal period for which funds are made available. They are based on projected labor force data, additional factors affecting the UI program and historic relationships between a variety of economic indicators. State forecasts are reviewed and factored into national projections by the federal Employment and Training Administration (ETA). Workloads then are apportioned among the states and a general relationship between each state's forecast of expected claims loads for the budget period and the national estimate is developed by ETA. The ETA estimate, in turn, must accommodate economic projections of the Council of Economic Advisors and other national administration official sources. These estimates then are matched with the "base claims loads" levels that will be funded.

With the cyclical, seasonal and regional variations, it is extremely difficult to project workloads. Nevertheless, the precision with which workloads are projected determines the adequacy of staff allowed each state for processing unemployment insurance claims. The combination of the estimated workload and the MPU factors produce the base level funding for each state.

Minutes per unit

The second part of the equation is the time factors developed by states through "Cost Model Studies." In essence these are time and motion studies. Time expended is recorded for activities related to standard, identifiable workloads processed during the measurement period. The result is a fully documented indication of the time required to perform each major element of processing a UI claim. Knowing the number of workload elements accomplished and the staff time required for each activity calculates into a "minutes per unit" (MPU) for each component in the UI process.

The Cost Model mechanism was developed by the secreatary of labor. It establishes standard measurement techniques and provides a common definition of the scope of activities. The needs for processing claims, within the requirements of each state's laws and procedures, thus are developed for each state.

Cost of the nationwide employment service plus the federal share of extended UI benefits and other costs are met from FUTA receipts.

Cost Model studies accommodate variations among states in statutory and administrative requirements. They permit adjustments in staff as workloads fluctuate from quarter to quarter. From the resulting factors for direct line operations also are developed the needs for planning, budgeting, personnel and staff for other management activities.

The key feature of the MPU time factors is that they accurately reflect the full cost of conducting UI operations within each state. In total, when applied to estimated workloads, they establish the total annual cost for administering the nationwide Unemployment Insurance program.

However, these systematically developed MPUs are not the basis on which the apportionments to each state are made. The MPUs identified for each state are revised downward by the secretary of labor to assure that the number of positions allocated to states does not exceed the number of positions that have been included in the president's annual budget request. These adjustments seriously affect the funding each state actually receives. The program needs have been methodically documented and justified through the Cost Model/workload estimating process. These needs nevertheless are modified arbitrarily by ETA to fit within a total funding ceiling. Quality of operation is sacrificed to a funding level not related to the Cost Model studies. The actual MPU factor used in the funding process, therefore, differs from the MPU factor developed from the Cost Model analysis of actual operating needs.

Base versus additional contingency

Almost as critical as the workload estimate and the authorized MPUs is the manner in which the total expected workloads are distributed between "base" and "additional contingency." Since different levels of funding are allowed for workloads assigned to each category, the distribution of total workloads between these two elements is a critical factor in establishing the adequacy of the funds granted to each state.

This distinction is intended to recognize that workloads may rise above or fall below the initial expectations.

> Base Funding is intended to provide a reasonable level of staff for the current program and administrative requirements necessary to process the minimum expected workload and to provide for the basic elements of administration of the Unemployment Insurance program.
>
> Additional Contingency Funding is intended to provide additional funding required for the portion of the workload above that included in the base; this funding predicates lower allocation criteria and fluctuates as workloads rise or fall during the course of the year.

Base funding presupposes a sufficiency for resources to support the minimum number of experienced staff who will provide a continuity of operations and stability, regardless of workload fluctuations.

In contrast, additional contingency funding presupposes that when workloads exceed base entitlements, temporary, part time and transitional staff (usually lower salaried) will be added to handle this excess workload on an as needed basis. The porportion of total expected workload that is funded at "base" is critical since the allowances for salary and NPS are lower for the contingency workloads than for those in the base. One major difficulty is that for the past several years, the base workloads nationwide have been arbitrarily fixed, while the actual number of claims processed has varied widely during the same period.

A reasonable method for establishing the base funding for each state for the fiscal year would be to relate the base workloads to past experience. If base workloads were established as not less than the lowest total claims loads processed in the preceeding five years each state would have a realistic basis on which to develop and retain a trained, permanent, full-time, competent staff to administer its program. Adoption of this criterion would require some changes in the current allocation and recapture mechanisms, as well as in the funding base recommended in the president's annual budget.

Nonpersonal services

UI program funding has two distinct parts — staffing needs, discussed above, which derive from the number of claims processed multiplied by the approved minutes per unit, and funding for nonpersonal service requirements.

The secretary's current method of funding for nonpersonal services does not address lease commitments, data processor or networks, telephone requirements or similar fixed needs for which the state may be obligated. Rather, nonpersonal services funds are apportioned in direct relation to the number of staff positions authorized. The allocations for nonpersonal services are complicated further by a distinction between "base" and "additional contingency." Thus the funding for premises is unrelated to the determination of the number of offices required to service the unemployed over a period of time: the formula presumes (inappropriately) that rental space can be expanded and curtailed within a short period of time in direct proportion to the number of claimants immediately served.

Recapitulation

The primary elements in financing the adminsitration of the nation's Unemployment Insurance program are the estimated workloads for the forthcoming fiscal period and the time factors established as necessary to maintain a fully effective program for the prompt payment of benefits and the prevention of fraud and other abuses. As a hedge against inaccurate estimates (which are made initially 21 months before the end of the fiscal period) only a portion of the estimated workloads (the base) is funded in advance — the rest (the contingency) will be funded only if and when the additional workloads occur. Only the base workload funding can be used to maintain the ongoing core of UI program staff; thus, where the switch from base to contingency is set becomes a critical issue.

The presumption of ETA is that many, if not most, of the costs related to administering UI programs vary in direct relationship to the number of claims, appeals or determinations processed. This presumption fails to recognize that a stable staff of trained, experienced, permanent people is needed to provide a basic cadre in each office; that in the highly complex programs that each state must operate, unskilled people cannot be brought in and expected to maintain satisfactory controls over benefit payments and collection of UI taxes. Further, many costs are fixed by their nature (EDP, office rentals, travel). These fixed obligations are based on the necessity of the agency to process peak rather than low cycle workloads. These cannot be expected to follow incremental changes in workload.

The base/additional contingency funding concept can be a very satisfactory mechanism for funding the core of the nationwide Unemployment Insurance program while providing flexibility to adjust to the vagaries of the actual claims loads to be processed if there is an adequate core funding provided for the operation of the network of local offices and other elements of the program that do not vary in direct relation to the number of claims

that are filed quarterly. A significant portion of the estimated claims loads, together with funding to maintain the staff and related costs for the network of offices, must be funded as the price for maintaining the capability to deliver vital services, and maintain adequate claims controls, during periods of rising or high unemployment.

The annual budget request of the Employment and Training Administration, which is included in the president's budget, retains a fixed number of claims as the base on which states will be funded for their core activities, rather than varying that base workload estimate in relation to the estimated total number of claims for the fiscal period. This method of establishing "base" funding offers little or no assurance to individual states that they will have the ability to retain a permanent cadre of staff fully trained to process the minimum number of claims that can be expected, nor to hold in place the network of offices to serve not only current claimants but also to maintain the ability to adjust rapidly to serve rising claims loads.

The fixed base workloads included in the president's budget frequently require marked shifts in resources among states, even though the workloads in many individual states may remain virtually unchanged. With a fixed number of claims established nationally in the base, and remaining unchanged from year to year, base resources must be shifted among states as higher workloads are expected in some states even though the number of claims in other states does not change. The states with the stable workloads, nonetheless, will suffer a reduction in their base funding since the ceiling on base workloads included in the president's budget forces ETA to apportion base funding among states in proportion to the level of claims activity expected for it in comparison to the budgeted number of claims nationally. This rigid base workload nationally effectively precludes the administrators in individual states from developing a trained cadre of staff that will remain intact from year to year.

Virtually all states support the use of objectively developed Cost Model MPU's as indicators of the time necessary to accomplish program goals. The principal argument states have with the MPU allowance factor is the unwillingness of the secretary of labor to use his own mandated Cost Model study factors without adjustment as the basis for each state's allowed MPU. Nationwide the current time factor allowances approximate only 84 percent of the factors that derive from the Cost Model studies. While a reduction of a fraction of a minute in a time factor seems modest, when applied to claims loads numbering in the millions, the reduction can be catastrophic. Short cuts must be taken in claims control, claimants' checks are delayed, long waiting lines develop in local offices, overpayment recapture and full review of claimant eligibility (factors that the former secretary of labor emphasized) cannot be implemented and tax collections slow.

These factors cause major philosophical differences between state administrators who are held accountable for properly serving claimants and employers, and the U.S. Department of Labor, which seeks impersonal formulae on which funds can be distributed.

State administrators, in general, do not quarrel with the adjustment of staff as workloads rise or fall so long as an adequate base staff is permitted. Such base staff derives from the proportion of the total expected claims activities that is funded as a minimum expected workload for the state. These base workloads should approximate not less than the lowest claims loads processed in each state during the immediate preceeding five years to insure a trained, permanent, full-time, competent staff for administering the major elements of the UI program. To fully meet the intent of "base" staffing to provide a permanent staff the current quarterly allocation and recapture mechanisms would have to be modified.

There are some fundamental differences in the approach to budgeting between the states and the U.S. Department of Labor. States must be concerned with the delivery of

services to individuals — the Department of Labor works within a national picture with primary emphasis on dollars expended.

There also is an increasing reluctance by ETA to recognize that there are legitimate differences among states in their program operations, that these differences reflect variations in state law, demography, service delivery mechanisms, etc., and that these differences deserve to be funded. Indeed, while such differences provide an inherent flexibility intentionally built into the system by Congress in 1935, ETA is seeking a mechanical and simple method for the distribution of funds that, as a by-product, has the effect of levelling the flexibility orginally built into the system to permit states to develop programs that adapt to the economic and philosophical variations among states.

Part III: Operating the system and economic impact

Interstate UI through Internet

by Jane Lowry Waid

How would you like to sit at your computer terminal and ask someone across the country a question? How would you like to get the answer the same day? Among the 25 states currently participating in Internet that is what frequently happens. The Unemployment Insurance Program is vast, and the interstate benefit program within it is a further complication. Before Internet the interstate program bogged down with delayed interstate UI payments, payments to possible ineligible individuals, lack of systematic fraud detection and high administrative costs. It felt like pushing an elephant through a small door.

The United States Department of Labor Region 10 states of Alaska, Washington, Idaho and Oregon, began piloting the interstate benefits project with the goal of streamlining the process. Initially the four states eliminated the "middleman" — the agent local office. The claimant now could file his weekly claim and correpsond directly with the liable, or paying, state. The agent office still was available for assistance, but the claimant did not have to report personally every week, and the agent office did not have to forward the claims to the liable state. The liable state also could contact the claimant directly. This allowed each state to administer its own eligibility criteria.

For Labor Market Information, the agent office obviously had the best information. The eligibility review process, although initiated by the liable state, fell to the agent office for the assessment of a claimant's current and continuing attachment to a labor market and to assist him in finding employment.

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To identify possibly fraudulent claims the pilot states implemented the interstate crossmatch. Here, the liable state identifies claimants who may have worked and claimed benefits at the same time. Those claimants are crossmatched against the agent state's employer reported wage records. These changes positively affected both the promptness and quality of interstate benefits. The next step was to improve promptness and quality of the initial claim stage, that is, setting up a monetarily eligible claim.

The Region 9 states of Nevada and California joined in the next phase — that of telecommunicating the initial claim from the agent office to the liable state. The claimant could now open a claim against another state and have the information reach the liable state within 24 hours! The liable state then could set up the claim and be ready to pay the first week filed by the claimant.

Expanding the system

The data process resources needed for this were complicated. Each state had to be compatable with common data elements, computer hookups, intrastate communications systems and above all, committment. The network hub was established in Nevada so that all transmissions went through that hub and out to its destination. It worked. An office in Kodiaiv, Alaska, could communicate quickly and directly with Oregon. A claimant could walk into a Nevada office and set up a claim in Idaho.

Other states and ETA began to take some serious looks at this pilot project. It looked like the interstate elephant was fitting through the door. In 1983, 45 years after the inception of the interstate benefit payment plan, all states began the Internet phase of eliminating the weekly filing of claims through an agent office. Fifty-four state and territorial agencies (including Canada) have agreed to share the responsibility of improving the interstate benefit payment plan by implementing Internet.

The next phase was to hook up all those states so the initial claim process could be telecommunicated, no easy task. Mainframes had to match up, hubs had to be selected and each state had to set up an instate computer network. The hubs selected were the Nevada hub, the Baton Rouge hub, and the Martin Marietta Florida hub.

In the spring of 1984, through the Martin Marietta hub, the first state outside of Region 9 and 10 states to communicate via terminals was Florida. Imagine the excitement of Alaska and Florida talking directly to each other! As the pilot testing proved, the results are improved payment time, a nationwide crossmatch and quicker responses to information requests. A side benefit is that claimstakers seem to feel a more personal touch between agencies by using the terminals.

Where is Internet going? Currently, Alaska, Oregon, Nevada, Texas, Missouri and Wisconsin, are piloting the next phase — the telecommunicated transfer of wages under the interstate plan from combining employment and wages. Savings in processing time and more accurate transfer of wages are anticipated, again helping the unemployed to receive benefits as soon as possible and cutting administrative time, costs and energy.

It all sounds like implementing Internet was easy. Internet required, and continues to demand, complete commitment from each state's administrative and data processing staff. The hubs require constant attention. The states need to be willing to give and take for the overall good of the project. Much credit for the success of Internet belongs to the ETA regional office for its vision and organization, and to the Nevada hub for its continuing efforts to improve and implement Internet.

Computerization

by Jim Coate

The timely payment of Unemployment Insurance during the system's first 20 years was a remarkable accomplishment! This intensely clerical task was accomplished entirely by hand. Just picture row after row of fat manilla folders, and ranks of typists sitting at machines, individually typing each determination and check. In another area you would see clerks sporting green eye shades busily calculating amounts with pad and pencil, posting to pieces of cardboard and occassionally remembering to place a hashmark on a tally sheet. Those were the days!

In the late 1940s and 1950s automation began to appear. Electric typewriters and posting machines with continuous feed forms steamlined the system. Special pegboards were "programmed" with wires and pins to produce monetary determinations, benefit checks, check registers and various reports. With this "modern" equipment came the first vestige of a wage file, using many linear feet of punch cards and mechanical sorting equipment.

The next step in the automation of the UI program came with the advent of IBM's 1401 processor. This equipment revolutionized the program. Wired boards were replaced by "computer memory" and punch card input. Elaborate accounting and statistical programs now were available to replace tedious and inaccurate manual tasks.

The 1960s and 1970s saw bigger and faster computers and the cathode ray tube (CRT) as an input device. Automation now was taking giant strides forward in the UI program. UI systems, both tax and benefits, began the process of automation; beginning with basic

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accounting but continually adding function after function. While not quite acheiving the "paperless office", UI is a pioneer in the automation arena. Our Internet project is an example not only of the application of computer technology to a specific problem, but also of what cooperation and dedication can accomplish. Who would have believed a few years ago that we would be communicating and transmitting claims from CRT to CRT across the nation?

Future technological advances

Of course the term "highly automated" does not apply to each of our states, but the move toward higher levels of automation is supported nationally both by increased automation funding and by decreased administrative funds. Automation provides the speed and accuracy for survival as resources dwindle. There are several model systems available nationally that make these higher stages of automation possible without investing many man-years of design effort and millions of dollars for implementation. While not perfect by any means they do address every part of the UI process.

With computerization, the possibilities of technological advances in the future are almost endless. Besides a national network connecting all states with wages and claim transactions, we are going to see increased use of microcomputers providing distributed processing in field offices, word processing, MIS information and terminal emulation.

Private enterprise should not be ignored as we design for future delivery systems. Lock box arrangements with banks to process tax dollars and reports can frontend our tax systems and directly interface to wage files at the same time. The dollar volumes involved will pay for many services such as data entry. Periferal devices attached to our mainframe computers become more advanced as time goes on. Scanning devices can read input documents, make decisions based upon available information and enter computer transactions or reject the form — all without human intervention.

Some states may experiment with direct claimant deposit through a connection to a bank computer. Just imagine, in a few short years we may see a claimant at 9 o'clock at night approach an automatic teller machine at the local bank, insert his credit card, punch a few buttons and file for his own benefits. Such are the possibilities, with the age of computerization.

Labor Market Information and UI operations

by Steve Goodman

For nearly 50 years, since the enactment of the Social Security Act of 1935, the provisions of federal and state laws have formed the basic framework of all Unemployment Insurance programs. Many amendments to these coverage provisions have been made, and Labor Market Information studies have been useful aids in determining if and when to make changes.

When the Social Security act of 1935 was adopted as law the exclusion of many types of employment from coverage was permitted. Several groups were excluded to avoid conflict with other government regulations. For administrative reasons various others were not included, but states were allowed to permit excluded groups to elect coverage voluntarily.

If a coverage provision was found later to be working well in several states, special studies were made and eventually legislative action taken by Congress. This especially was true when the size of firm coverage was changed in 1956 and 1972. Each time special studies of Labor Market Information on wage histories and population characteristics were conducted to determine additional staffing and funding requirements.

Many more studies using Labor Market Information were conducted during the late 1960s and early 1970s before two other major changes were made to the coverage provisions of the Unemployment Insurance laws. The Employment Security Amendments Act of 1970 and the Federal Unemployment Compensation Amendments of 1976 expanded coverage to many million workers. With these changes, by 1978 coverage of

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wage and salary workers under all federal and state Unemployment Insurance programs had exceeded 95 percent.

Labor Market Information is essential

Financial studies relating to the entire labor market thus contain vast amounts of useful information that can be used in making UI payment forecasts. Labor market demographic information is now interchangeable with characteristics of the covered workforce in many fields on a percentage basis and in various cases for raw data.

Since the start of the Unemployment Insurance program Labor Market Information has played many roles. During the first three decades employment characteristics data and wage histories were important in determining expansion needs. Presently financial studies and warrant forecasts are the main areas in which UI personnel use Labor Market Information.

Further expansion of the covered workforce is not expected, therefore, a reasonable degree of accuracy can be presumed when projections of labor force data are used to aid in forecasting statistics of the insured workforce. The future of Labor Market Information analysis using Unemployment Insurance data will undoubtedly be essential to understanding where and why unemployment trends occur and for which occupations the unemployed should be trained.

The Employment Service-Unemployment Insurance relationship

by Charles H. Davis

The Stock Market crash of 1929 ushered in an era of gloom never before seen in the United States or the world. What was thought at first to be only a temporary backslide in the economy turned into a global depression that would last a decade. Unemployment, which had averaged around 3 percent, suddenly zoomed to around 25 percent of the labor force. Banks folded nationwide causing many to lose their life savings. Those banks that did survive often turned unemployed mortgagees out of their homes, creating a tribe of involuntary nomads doomed to a life of roaming the countryside in search of work.

Feeling that the economy would somehow correct itself, President Herbert Hoover did little to alleviate the sufffering of millions. After surviving four years of government inaction, the electorate turned out the Republicans and placed Franklin D. Roosevelt in the White House. During the cruelest year of the "great depression," 1933, President Roosevelt and the Congress began making changes.

The Wagner-Peyser Act of 1933 created a federal-state system of labor exchange that exists to this day. The United States Employment Service (USES) occupied the federal role and established minimum standards to ensure a level of consistency among the states. The states then were free to establish procedures for the recruitment and selection of applicants, the solicitation and listing of job orders, and the establishment of administrative support essential to the operation of the program.

As the long list of unemployed individuals continued to grow, so did the feelings of anxiety among those lucky enough to be employed. Prior to the "great depression" the

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few attempts by state legislatures to introduce laws concerning Unemployment Insurance failed except in one state. Wisconsin did pass an Unemployment Insurance law in 1932, and it remained the only one on the books for three years. Because of the slowness to act on the part of the states, and because of the failure of many state and federal relief programs during this time, a groundswell of support for the creation of a federal Unemployment Insurance program began to emerge.

Responding to this challenge, President Roosevelt and the Congress created the Social Security Act of 1935. Designed to protect the financial security of older Americans, this legislation also included two titles that pertained to Unemployment Insurance. Title III established the present Unemployment Insurance (UI) system and Title IX the UI Trust Fund.

Objectives of UI program established

Realizing that constitutional reasons would prevent the federal government from compelling states to establish Unemployment Insurance systems through the Social Security Act, a tax offset procedure was set up that made it foolhardy for a state to refuse the establishment of an Unemployment Insurance program. A federal unemployment tax was imposed on all employers subject to the legislation. However, a state adopting an approved UI program was allowed to collect 90 percent of the federal tax. Furthermore, a state was allowed to tax employers at less than the amount of the 90 percent offset, the beginnings of experience rating. Any state refusing to establish a UI program subjected its employers to paying the full federal tax. Little time was needed for all states to establish UI systems.

The objectives of the UI program are the same today as they were 50 years ago and are worth noting. The main goals are:

1. to prevent the spread of involuntary unemployment;
2. to maintain more stable employment and economic stability; and
3. to accumulate funds during periods of relative prosperity to provide benefits for periods of unemployment.

The Social Security Act of 1935 contained a provision that required all UI benefits to be paid through the public employment offices established two years earlier by the Wagner-Peyser Act. This arrangement marked the beginning of a lasting relationship between the Employment Service (ES) and Unemployment Insurance.

The reasoning behind this requirement is fairly obvious. By exposing UI recipients to the job market each time they filed for benefits they would return to work sooner. Also, by offering referrals to suitable jobs, the availability of UI recipients for work could be monitored. This marked the beginning of the work test rule.

During the first few years of operation, ES primarily referred individuals to emergency work and relief programs. This practice helped create an unfavorable image of ES as an agency suitable only for referring unskilled individuals. As a result many employers shied away from contacting local employment offices for workers.

The advent of Unemployment Insurance figured to change this image since recently unemployed workers with experience and skills would now be available for referral. However, a sharp economic downturn in 1937-38 resulted in large numbers of workers not covered by UI inundating local offices to register. Since these workers were generally unskilled, the stigma remained.

Bureau of Employment Security established

During this period, ES and UI were suffering through a nomadic existence within the federal bureaucracy. The Wagner-Peyser Act placed ES in the Department of Labor, while UI fell under the jurisdiction of the Social Security Board. An agreement between the Secretary of Labor and the Social Security Board was reached on March 30, 1937, which allowed for the operation of ES and UI as a single agency. The new Bureau of Employment Security encompassed ES and UI until World War II.

In some ways the war years were good ones for ES and UI. During this period the federal-state partnership was dissolved and the state ES systems were federalized under the War Manpower Commission. Labor surpluses became labor shortages and unemployment disappeared practically over night

Following the war, ES and UI were transferred to the Department of Labor. On July 1, 1948, ES and UI again became part of the Bureau of Employment Security. Finally, in 1949 ES and UI were transferred back to the Department of Labor where they have remained to this day. Obviously this constant shifting created tremendous organizational and identity problems.

While there was great movement on the national level, change has not been as drastic on the state and local levels. For the first 25 years ES and UI generally operated out of the same local office. However, by the early 1960s changes were underway. Emphasis was placed on separating the two services as much as possible. Local offices in the larger metropolitan areas were the first to be separated. This move represented a significant change in the operations of ES and UI and set a precedent for years to come.

The separation of local office operations has been viewed by some as possibly being counter productive to ES and UI coordination in the area of work test. As stated earlier, one of the original requirements of the Social Security Act was that UI payments be made through the local ES offices. In order to qualify for UI benefits an unemployed worker had to demonstrate a recent attachment to the labor force and an on-going attachment. The on-going attachment to the labor force only could be fulfilled by being able and available for work. Thus, claimants were required to register with ES, and work test was born. With out doubt, work test best exemplifies the desperate need for efficient coordination and communication between ES and UI.

This test of availability is crucial to the successful operation of the UI program. Lax application of the test could result in large numbers of individuals receiving benefits who are not truly in the labor force. Such action could not only drain UI trust funds, but also make a mockery of the UI system. However, rigid application of the test could result in the destruction of one of the main values of the UI system, the self-respect of the UI claimant.

"Work Test" created problems

The segment of work test that ES is most involved with concerns the search for work. The purpose of having UI claimants register with ES is that the claimant's availability for work could be tested by offering suitable employment. A major difficulty with work test has revolved around the word "suitable." A large portion of the jobs available through ES simply do not pay enough to constitute a work test for many applicants.

In addition to the problems encountered with suitable employment, ES and UI face other difficulties in dealing with work test. Some claimants are simply unable to benefit from ES assistance since they are on temporary layoff with a high probability of returning

to their jobs. In other cases employers cannot or will not substantiate reports that claimants did not appear for job interviews. In still other cases local office records have been found to be inadequate or in error. No matter how many problems have been encountered with work test, it remains an essential part of ES and UI operations.

No discussion of ES and UI could be complete without touching on the area that links the two so strongly as funding. Since 1935 the primary source of funding for ES and UI has been the taxes paid by employers under the Federal Unemployment Tax Act (FUTA). These taxes are collected and deposited in the Unemployment Insurance Trust Fund. In turn, these taxes are used to cover the costs of unemployment benefits as well as the administrative costs of both the ES and UI programs. This method of financing makes the ES and UI systems among the most innovative social programs ever devised. Approximately 97 percent of the money needed to operate the ES offices comes directly from employer taxes, as well as all UI administrative funding.

Whereas the source of financing the ES and UI programs never has been in controversy, the method has been. During the 1930s there was some disagreement as to whether a flat rate or a variable rate of contributions based on experience with unemployment should be used. Experience rating won out and is now written into every state UI law.

Many critics claim that experience rating has been an impediment to adequate benefits. Also, in recent years some have claimed this method has been an obstacle to sound financing. One need only look at the large number of outstanding loans extended by the federal government to the states to understand the reasoning behind this argument. Although the tax base has been increased from $3,000 in 1935 to $7,000 today, problems still persist. Further research into the structuring of experience rating still is needed in order to maximize solvency of state UI trust funds.

Despite the number of problems faced by ES and UI, the two have performed admirably for 50 years. There can be no doubt that both have served the people of this country well. It is difficult to imagine how the country could have survived the "depression" or the recessions that have followed without the services of ES and UI. Changes may be needed in the future for both systems, but there indeed will be a future for both.

UI's effect on the local economy

by W.E. (Ted) Parsons

Many employers find payment of unemployment taxes or benefit cost distasteful because they believe they receive no benefit from the payment of Unemployment Compensation. The employers are sometimes told that the financing of benefits is "a cost of doing business." Actually it well may be a hedge against the total collapse of the economy in a time of recession.

In addition to the stabilization of the work force, Unemployment Compensation has other significant positive impacts on the economy. Unemployment benefits are paid to wage earners who have been deprived of their income, usually unexpectedly. A safe assumption is that the recipients of the benefits immediately will begin to spend the money for the basic necessities of life and that all of one week's benefit check will be spent before the next one is received. Statistical research indicates the bulk of unemployment benefits go into the economy first for the purchase of retail goods, services and nondeferrable expenses. The retailer realizes gross income, which is available for the payment of salaries, the purchase of wholesale merchandise and the other expenditures necessary for the operation of the business.

When the retailer purchases his goods and services from the wholesalers and providers of other services, the gross income again is available for the payment of salaries of employees and the purchase of goods and services required in the operation of these businesses. The gross revenue realized by the wholesaler and provider of other goods and services again is available for return to the economy in the same manner as in the case of retailer. This cycle goes on indefiniteiy.

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The portion of gross revenues from each spending cycle that is used to pay salaries will reenter the economy in much the same manner as the original unemployment benefit money did and will probably be spent more for goods and services that have progressivley higher consumer taxes, ranging from sales tax of about 6 percent to liquor tax of more than 25 percent. Some portions of gross business revenues not spent for salaries of employees may be spent for such items as motor fuels for transportation of goods from warehouses to retail stores etc., which also have high consumer taxes. Other portions will be spent for goods and services which generate other tax revenue.

Progressive spending cycles

The tax revenues used for the administrative cost of the Unemployment Compensation Program are spent largely for the payment of salaries of persons employed in the operation of the program. The remainder is spent for goods and services required for the operation purchased from the private business sector. These expenditures follow the same economic cycle as outlined above. There is good reason to believe that the net profits realized from the progressive spending cycles generated by the payment of unemployment benefits is sufficient to pay the payroll taxes used to finance the program, or in the case of governmental employers, local tax revenues, to pay benefit cost.

Total unemployment benefits paid by the Alabama Unemployment Compensation Agency in the fiscal year ending September 30, 1983, amounted to $338,272,823. If the spending cycle can be traced only 5 times through the economy (independent economic analysts in Alabama say this factor is a safe assumption), more than $1.6 billion of spending power is generated. The spending cycle usually begins locally in the community where the claimant resides, which will normally tend to be an economically depressed area. This places the positive impact on the economy in the geographical area where it is more beneficial.

In a program of this magnitude it is unrealistic to assume that the program can be administered without error or fraud. Some unemployment benefits are paid to claimants who have filed fraudulent or improper claims or claims will be paid incorrectly through clerical error on the part of agency personnel or improper reporting by employers. These claims constitute a small percentage of total claims, and a large portion of improperly paid benefits is recovered from the claimant. Identified Unemployment Compensation payments made in Alabama during the fiscal year ending Sept. 30, 1983, on claims involving fraud, misrepresentation or some type of error, including improper employer reporting, amounted to $7,765,160 or 2.29 percent of total benefits of benefits paid. Of this amount, $4,079,321 was recovered during the year, leaving 1.09 percent not recovered as of Sept. 30, 1983, (Net amount of benefit payments involving claimant fraud and not recovered amounted to less than one half of 1 percent); additional amounts will be recovered.

If employers and the public will view the overall program in this light it will be better accepted.

A divergent paradox

by John Stine

Some economists recently have said that unemployment benefits should be reduced. Others claim the Unemployment Insurance program has outlived its usefulness.

Conversely, the 1934 initiated UI program has been hailed by many as a primary stabilizing force in a mobile society. Others point to its historical performance as proof that the program remains viable and necessary in a free society.

Rather than contradictions, these two extreme points of view only seem to emphasize the variables that naturally might be expected in any free society debate. For instance, few will argue that UI has not had a significant impact on the economy. But surprisingly a growing number of people are beginning to question the consequences of that impact.

Consequences, for the most part, are thought of as negatives. That notion is false, but since people tend to think of them in that way it should be considered prudent for Unemployment Insurance professionals to examine closely the variables inherent in the ongoing national debate.

Fifty years of economic impact

The cost and effect of Unemployment Insurance was a great unknown in 1934. But the time was right. Bread lines and other "great depression" indignities literally demanded that some sort of government mechanism be provided to prevent that sort of thing from happening in the future.

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The idea that insurance was the answer to the risks of economic instability was the 'mood of the moment.' Government insurance programs proliferated during the decade of the 1930s — Social Security, old age assistance, retirement and pension plans, workmens' and unemployment compensation, to name a few.

It is fairly safe to assume that all of these 'insurance' programs had an impact on the economy. Like UI, they were all started without an inkling of their long range consequences. But "the experience acquired since then," wrote R.G. Wagenet, director of the then Bureau of Employment Security, in a forward to a book written in 1948 by W.S. Woytinsky, "has cast light on some problems that could not be solved at that time." Wagenet further asserted, "We have learned to visualize compensable unemployment as a function of several variables that reflect the dynamics of the labor market."[1]

Wagenet was referring primarily to costs, as was Woytinsky, described as the principal counsulting economist for the ES bureau, in his book, *Principles of Cost Estimates in Unemployment Insurance*, but both writers also touched on economic impact issues. To quote Woytinsky: "It seems fairly certain that the United States, after having liquidated the primary postwar boom, will enter a period of expansion analogous to that in the 1920s."[2]

Woytinsky was prophetic. From 1948-1958 and beyond, business boomed. The fledging plastics industry, for one, grew by leaps and bounds. Aerospace programs, among others, absorbed the unemployed, provided ample salaries for workers and developed exciting new products. The "good life," long hoped for by preceding generations of working Americans, became a reality.

With rising affluence there also developed a growing feeling of social frustration and unrest. Young workers, in particular, began to question the "fruits" of the good life. And the poor began to question the "spoils" of the wealthy.

Surprisingly, social revolution was the unfortunate consequence of America's perceived economic disparity. Houses, stores and other buildings were burned and looted. People were killed. Students marched and "poor people" camped along the Potomac.

Shocked that civil disobedience could stain American soil, the government responded with new laws, new social programs, new federal departments and agencies to dictate and regulate the state of economic and social life in America. The UI responses to those socially troublesome problems were increases in benefits and covered employment, extensions of benefit periods, or both. In many ways the UI program at both the federal and state levels kept pace with the mood of the times.

Causes and effects

Today, some 50 years since enactment of the UI program, America's approach to employment problems still is evolving from variables. In some respects that ever changing response might well be traced to the nation's manpower policy; or, to the whim and fancy of the incumbent federal administration when such a policy is lacking.

To illustrate consider the insight of Seymour L. Wolfbein, then special assistant to the secretary of economic affairs, United States Department of Labor, in a book he authored in 1965 titled, *Employment, Unemployment, and Federal Policy*. "The world

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[1] *R.G. Woytinsky*, Principles of Cost Estimates in Unemployment Insurance, *Federal Security Agency, Social Security Administration, page iii.*

[2] *op cit, page 147.*

of work is always changing," wrote Wolfbein, "and eternal vigilance aimed at keeping the worker up to date is the price of full employment."[1]

Full employment was the watchword of nearly everyone during those years. Economists and social planners alike thought it was the ultimate mandate of an affluent society. "Since it is always more costly — personally, socially and financially — to maintain people in idleness," Wolfbein noted, underscoring a reference to social insurance programs, "an active manpower policy does not try to aid the individual only in his development in the world of work; it also steps in when the person is unemployed or physically or mentally incapacitated, in order to help him back into the mainstream of gainful activity."[2]

Not so, claims author and economic interpreter George Gilder, in his hardsell explanation of current "supplyside economics," title *Wealth and Poverty*, published in 1981. "There is abundant reason to believe," Gilder states, "That the American welfare state long ago passed its point of diminishing and counterproductive returns, that the insurance features of American society now so overbalance the risk features that everyone — rather than just the direct victims of hardship or change — feel anxious and insecure."[3]

While Gilder's assertion that "everyone feels anxious and insecure" may be gilding the lily just a bit, even Wolfbein sounded a warning concerning the effect of national policies. "The acid test of all public policy," he wrote, "will continue to be the results as they show up in the United States labor force, in the success we achieve in reducing joblessness, not only overall joblessness but among the various sectors of the population as well."[4]

Exactly!, Gilder implies. Historical experience now shows that joblessness has increased, and he seems to feel the morals of the working population have declined. Further: "The moral hazards of current programs are clear. Unemployment compensation promotes unemployment."[5]

But Gilder does not stop there. His is not an indictment of just UI, but of the whole array of 'insurance' programs — Aid to Families with Dependent Children, Social Security, disability, farm loans and subsidies, and even The Manpower Development and Training Act and The Comprehensive Employment and Training Act, to name a few.

Gilder's feeling is that all of these programs (designed primarily for the poor) only promote the value of being poor (the credential of poverty), and thus perpetuate poverty. All of these programs, he states, should be modified, "usually by reducing the benefits."[6]

Gilder is not alone in his negative assessment of UI benefit effects. From a paper on Unemployment Compensation prepared for the Massachusetts Divison of Employment Security in 1979, Andrew Sum and Maryann Bouda reveal just how UI has become an apparent moral hazard and the causes for it. Twenty four percent of the unemployed in the Massachusetts work force, Sum and Bouda have found, say they want jobs but do not seek them because of the attractions of welfare and other government support. Nearly 84 percent of those out of the labor market "do not want a job now."[7]

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[1] *Seymour L. Wolfbein*, Employment, Unemployment and Federal Policy, *Random House, 1965, page 122.*

[2] *ibid.*

[3] *George Gilder*, Wealth and Poverty, *Basic Books, 1981, page 111.*

[4] *Seymour L. Wolfbein, op cit., page 197.*

[5] *George Gilder, ibid.*

[6] *Andrew Sum and Maryann Bouda, paper on unemployment compensation, prepared for the Massachusetts Division of Employment Security, February 1979, and referenced in* Wealth and Poverty *by George Gilder, op cit., pages 157 and 281.*

Other variables

Supplysiders argue long and loud that productivitiy is the key to a strong economy, not government makework schemes, indulgent insurance programs or bloated federal budgets to finance the machinery needed to administer and regulate the "helping" programs of a benevolent society. To illustrate, from a book authored by Frederick W. Hornbruch, Jr., titled *Raising Productivity: Ten Case Histories and Their Lessons*, a productivity improvement effort by the commerce department is described. Basically, a special productivity team was selected and trained to apply efficiency standards in selected areas of the Census Bureau. The initial result was a 52 percent increase in productivity. The conclusion was that like workers in nearly all industries government employees work at about 60 percent of a reasonably high level of production when there are no standards or measures of performance.

When the Census Bureau launched a fullscale productivity program, the effort rose to 91 percent. When wage incentives were added productivity increased to 125 percent and more of the standard. This prompted an obscure consultant analyzing the census productivity program to conclude that Congress had created a working environment for government operations where the "name of the game" is to obtain a generous budget, "and then make sure it is all used by the end of the fiscal year. This climate must be changed."[8]

Federal budgeting methods are seen by many as another counterproductive economic element impacting the economy. In many respects, the efforts of UI program staffers and others in recent years to maintain a personnel level considered sufficient to do its work may well have been viewed by many as an attitude dictated by motives similar to those Hornbruch described.

On the other hand, Aaron Wildavsky, in his book, *The Politics of the Budgetary Process*, has aided and abetted the UI staffing maintenance effort by rationalizing that people do not always realize "what is good for them." They may not recognize "the benefits flowing from certain policies," he says, and they may find it difficult to support policies that "are meritorious but not directly related to individual constituencies." He advises strategies. Where support is lacking, Wildavsky says, it may be mobilized; where attention is unfocused, it may be directed by advertising; where merits are not obvious, they may be presented in striking form. "The ability to devise strategies to advance the recognition of merit," Wildavsky advises, "is immensely more helpful than cries of indignation that political craftsmanship should be necessary."[9]

UI in the real world

In retrospect, supplysiders denounce government insurance programs as counterproductive. And UI is an insurance program, one of the oldest. But here there develops a divergence, one that might well place a radiant complexion on the perceived value of the program.

Wolfbein touched the heart of the issue when he wrote, "programs such as unemployment insurance can be viewed as mechanisms for helping maintain a part of the labor supply during temporary period of joblessness."[10]

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[8] *Frederick W. Hornbruch, Jr.*, Raising Productivity: Ten Case Histories and Their Lessons, *McGraw-Hill New York, 1977, page 66.*

[9] *Aaron Wildavsky*, The Politics of Budgetary Process, *Little, Brown and Company, 1964, page 177.*

[10] *Seymour L. Wolfbein, op cit., page 164.*

Wolfbein is surely describing an economic impact function that benefits workers and employers alike, not just the poor and unskilled, but the employers of the nation who must depend on an available labor supply to produce the goods and services supplysiders insist makes the economic climate bloom and grow.

Just as surely, Gilder, while denouncing UI as a morally bankrupt (socialist) system, may have inadvertently overlooked the implications of his primary theme. "Capitalism," he wrote, "begins with giving."[1]

Even the Massachusetts Sums-Bouda survey cannot realistically be considered an indictment against the UI program. Rather it simply underscores and fortifies the notion that other government programs have made idleness more attractive than work. The difference may well hinge on the reality that UI is a "giving" function of business while all the other programs are financed from general government revenue.

The notion Gilder promotes is that investors and the owners of business enterprise must first "give" of their dollars and talents before a hoped for profit can be expected. Not knowing at the outset, or at any other time, of their chances for success or failure they must be given the freedom to try to share in the "surprises" of unbridled capitalism.[2] Based on this reasoning even Gilder seems to have inadvertently reaffirmed the value of UI to the economy.

Realistically speaking, UI (albeit a payroll tax) is giving with the hope and expectation that the "gift" will entice the work force to stay put, temporarily at least. Given that premise, it is a program that helps both worker and employer while simultaneously serving to stabilize the economy of the community of which they are both a part.

Looking ahead

For 50 years, the UI program has served the nation through economic depression, recession and good times. To the minds of most people its impact on the economy has been positive and beneficial.

Among concerned Unemployment Insurance professionals, the UI program should be considered a program well worth defending — in Congress, in the federal administration, in the budgetary process, and throughout the social fabric of the American nation.

And for those who truly know, the UI program also may be rightly considered one of the most cost effective, responsive and adaptable federal-state partnerships in existence.

In many ways it might be considered sad if the UI program were to become an unfortunate pawn in a clash between economic ideologies and federal policy. The continuing diligence of Unemployment Insurance professionals could well prevent that from happening.

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[1] *George Gilder, op cit., page 1*
[2] *op cit, pages 21-27*

Part IV: The future

Alternative uses of UI benefits

by Garth L. Mangum and Stephen L. Mangum

Throughout its 50 years, Unemployment Compensation has been praised as the first line of defense against income deprivation and labeled an encouragement to extend the period of joblessness. But that has not been the only point of ambivalence. Most economists who think about the subject probably would consider the costs of Unemployment Compensation to be paid by employees. The pressure on employers is to minimize labor costs. In reality, it makes little difference whether the labor costs incurred in offering employment are paid in wages, fringe benefits or payroll taxes. In that concept, UI taxes represent a deduction from other benefits that might have been paid to employees.

But employers don't usually see it that way. They sign the check sent to the Employment Security agency. They consider it their money and want not only to minimize it, but to determine its use. That sets up another basic ambivalence.

The Social Security Act recognized four sources of income security in an industrial society. The extended family, which had undergirded the agrarian society, was dying as an economic entity. Government would have to protect the nuclear family. There would be no economic role for the too young and the too old. The business cycle would be inevitable. Some would simply be unemployable. Defense against all of those threats was addressed in what has to be one of the great landmarks in public policy. It all worked remarkably well until the nuclear family began to give way to the fractured one — but that is another story.

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Though all agreed that UI should provide family income maintenance to tide over temporary periods of unemployment consequent to the business cycle, there was always an ambivalence concerning what that meant in human resource terms. To employers in cyclical industries of high skill content it meant preservation of a work force until recall was possible. They did not want their employees to find other permanent jobs. Those employers with low human capital investment and uncertainty as to future labor needs only wanted to minimize the costs of layoff and preferred the most rapid reemployment possible.

Employees shared the same ambivalence between those who perceived their employer attachments as permanent and wanted sustenance until recall as contrasted to those who lacked and perhaps did not want long term prospects. Some with limited dependent needs even may have perceived the system as a source of periodic paid vacations.

Preservation of human capital

At the public policy level there were those concerned about the preservation of human capital who did not want the skilled directed into unskilled work, those concerned primarily about family income maintenance and those who simply wanted to minimize budgetary costs.

Throughout the sub rosa debate, employers paid the payroll tax. They dominated the state advisory councils, were the ones listened to by the state legislatures and vied with organized labor for influence in the Congress. Despite rhetoric about availability for work and job search, preservation of the work force until recall prevailed.

But the uncertainties of the past decade have changed much of that. The permanently displaced worker is a too familiar figure. A system that encouraged one unlikely to be recalled to ride out a six month or longer income maintenance program before facing the need for serious career readjustment is doing a disservice. Employers are rethinking the advantages and disadvantages of maintaining work force attachment. Increasingly they carefully select, invest in and seek to retain a small core of permanent employees while maintaining access to but minimizing responsibility toward a periphery to temporary workers. Call-ins, limited duration hires, subcontracting, casuals and temporary help services are some of the devices used.[1]

All of that has sparked discussion of alternative uses of the Unemployment Insurance system. All of these suggestions focus debate on retention versus readjustment and income maintenance versus the flexible payment of readjustment costs.

The oldest debate is over retraining during the benefit period. That there was ever a doubt indicates the strength of the workforce preservation policy. One by one the barriers against undertaking retraining while receiving Unemployment Insurance have been knocked down. The remaining issue, which differs by states, is whether participation in training shields the recipient from the necessity of job search or whether availability for work, even at the cost of dropping the training program, must be maintained. However, an issue as yet unaddressed is whether UI moneys can be used for other than income maintenance while training, for tuition or purchase of books, for instance. Since the duration of most worthwhile training exceeds the benefit period anyway, it is unlikely that diversion of income maintenance funds to training expenses would contribute to

[1] *Garth L. Mangum, Don Mayall and Kristin Nelson, "The Temporary Help Industry: A Response to the Dual Internal Labor Market,"* Industrial & Labor Relations Review, *July, 1985.*

training completion and reemployment. The exception would be when the UI recipient previously had undertaken and was within a short period of completing a structured program in an educational institution. Actually, tuition and books are not major expenditures in many publicly supported education and training institutions and other funds may be available, such as under the Job Training Partnerhsip Act, which cannot be used for stipends.

A most positive approach might be to authorize the spreading of the usual 26 weeks of UI support over a nine month, 12 month or longer period at the same total cost, perhaps in concert with parttime employment or other support to allow completion of an approved education or training program achieving a higher level of skill and job security. There could be other valid reasons for spreading out entitlements including bridging a time gap until imminent retirement for an older worker or melding with part time employment while engaged in pursuing full time pursuit of some valid reemployment goal. Of course, all of those would encourage use of the full entitlement package with consequent increase in total UI costs.

Investment in the UI recipient

There has been a recent proposal to allow a UI recipient to withdraw potential benefits for investment in selfemployment.[2] It is a part of the present enthrallment with small business and entrepreneurship. There are also reports of success in Europe. The realities are not promising. The sum involved for most recipients would be under $3,000. Investment of that entire sum would leave nothing for income maintenance. Most new small businesses fail within the first year. The most prevalent reason is undercapitilization. The next is lack of managerial capability. To have the skills to provide a useful product or service is quite different from having the accounting, legal, marketing and other management knowhow, as well as the dedication, to operate a successful business. Job Service personnel also lack the knowledge to provide useful counsel and advice. There are various private and Small Business Administration sponsored programs to provide such support — none of them remarkably successful. At most UI should be used for income maintenance while pursuing self employment with other support.

Use of UI benefits to either explore prospects for or underwrite the expenditures of relocation are other possibilities. Despite the high average mobility of Americans, relocation never has been a popular policy cure for unemployment. Politicians are not anxious to use public funds to pay for the exit of their constituents. A high proportion of those who leave in search of work soon return usually because of the absence of a support system for finding work and settling into a new community. Numerous experiments under the Manpower Development and Training Act found the actual out-of-pocket costs of relocation to be surprisingly low and guidance, placement and psychological and social support to be the most important factors.[3] Those who migrated unguided tended to follow kinship support patterns, which took them to locations already over supplied with people just like them. The greatest success appeared when relocatees were guided to areas of available jobs and provided with coaching support while settling in. Mere division of IU funds, experience suggests, is unlikely to suffice.

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[2] BNA Employee Relations Weekly, *Bureau of National Affairs*, Vol. 3, p. 601.

[3] *Sar Levitan, Garth Mangum, Roy Marshall*, Human Resources and Labor Markets, *New York: Harper and Row Publishers, 1972 (first edition), pp. 539-46.*

Subsidized on-the-job training is the component of the Comprehensive Employment and Training Act (CETA) that carried the highest cost benefit payoff, and there is no reason to think that will not still be true under JTPA. The major obstacle was convincing employers that they were not being asked to take on simultaneously a load of government red tape and a substandard worker. Both fears might be lessened with UI recipients and a program less perceived as federal. The UI benefits might be paid to an employer in return for a promise of skill upgrading and retention.

Since a layoff decision also might have been marginal, a current employer might be persuaded to keep the potential UI recipient on with the benefits used as a wage subsidy and the added bonus of no unfavorable impact on the employer's UI tax. There would, of course, be administrative problems in assuring that the layoff threat was real and that the result would be tiding-over a short term problem retaining permanent employment.

Another series of considerations really involve The Job Service providing services it often does not, but always should have been available to all including, but not limited to, UI recipients. The first and foremost of these should be job search training.[4] While supported by UI benefits is the ideal time to be taught how to effectively search for a job, provided with information and coached through a self directed search process. Job Service should, of course, receive the same rewards for guiding the individual to find his or her own job as for making a direct placement.

Possible innovations

Related is a brokering approach to placement. Private employment agencies would be starved out of existence if they waited for employer job orders. They are more selective than The Job Service can be in which workers they choose to aggressively market. But there is no obvious reason why Job Service personnel cannot make the same direct marketing contacts with employers on behalf of job seeking individual known to have characteristics attractive to the employer. Perhaps placement bonuses to Job Service personnel is worth an experiment. The cost of some of this might be compensated from reduced UI expenditures. It probably would be going too far to pay a private employment agency to market and place a UI recipient.

All of these possible innovations have their advantages and disadvantages, and some of the latter obviously outweigh the former. Some are eminently worthy of experiment, and others should be rejected outright. Generally UI should be retained for income maintenance with other resources marshalled to accomplish reemployment goals during the period of UI support. JTPA with its abolition of the stipends that prevailed under MDTA and CETA is an obvious partner. Spreading out the time period for receipt of the same amount of UI benefits or using them to susidize employment meets the income maintenace test.

What raises the issue of UI diversion is the prevalence of the displaced worker unlikely to be recalled and in need of major career readjustment. The perverseness in UI lies not in the few who will take a free ride during a paid vacation, but the many who will unrealistically wait for recall, facing the unpleasant fact of permanent displacement only when the UI period wanes. Essential is an early assessment of reemployment prospects, certainly with joint individual and Job Service partnership and preferably with previous employer consultation. On conclusion that early recall or replacement in a comparable

[4] *Miriam Johnson*, State of the Art in Job Search Training. *Salt Lake City, Utah: Olympus Research Centers, 1982.*

job is unlikely, a cafeteria of reemployment services should be available to support an individualized reemployment plan. Job search training, retraining, extended education, subsidized OJT and relocation assistance all should be on the menu. In unusual circumstances self employment could be considered.

An individualized, payroll tax supported, reemployment package has been suggested and is worth exploring.[5] Certainly The Job Service as the central labor exchange mechanism and purveyor of UI benefits would have to be the broker and marshaller of available resources. Title III of JTPA should be the primary source of displaced worker assistance. It strains credulity to hear that all the minimal appropriated funds are not being spent and recission is considered necessary. Given the prevalence of displacement, administrative obstacles or lack of commitment are the only obvious explanations. A central role for The Job Service in displaced worker remedies would be some compensation for the subordination of Wagner-Peyser to JTPA. With UI and Aid to Families with Dependent Children for income maintenance and JTPA and other sources for funding of appropriate labor market services, an effective cafeteria approach to reemployment planning should be possible.

[5]The Displaced Worker in American Society: An Overdue Policy Issue, *Washington, D.C., National Council on Employment Policy, February, 1983, p. 15.*

Incentives, productivity keys to future

by Clinton E. Petty

"All must act, or there will be no action," said New York Gov. Franklin Delano Roosevelt in 1931, speaking to other governors on the necessity for concerted action to establish Unemployment Insurance systems within the states. The devastating burden of unemployment so evident in those years of depression had aptly demonstrated the need to act. Yet states had avoided unilateral action, fearing that any UI employer requirements would mean a competitive disadvantage in their business climate. The resolution of these conflicting needs is the source and rationale of our federal-state system.

The tension demonstrated in this conflict continues at the center of our UI system, and perhaps at the center of our national psyche. One side it is not only compassionate, but sensible, to support each other in times of trouble — to maintain our human resources. Yet Americans admire the values of self sufficiency and identify strongly with the hero who pulls himself up by his own bootstraps.

This is useful historical context in which to examine the changing perceptions of the Unemployment Insurance system, and more specifically, to address the question of whether changing perceptions require changes in the system itself.

Devolution: change in the federal-state partnership

With the publication of the federal Fiscal Year 1986 budget, attention is forced to focus on the federal partner. The present administration has made clear its stand:

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"Working with the states, the administration will develop and propose legislation to devolve to the states the responsibility for managing and financing their Employment Services and Unemployment Insurance Services. The Federal unemployment tax will be reduced accordingly, freeing tax resources for the states. The legislation would become effective in 1988, allowing the states time to adjust their laws. This proposal would encourage efficiency in state administration by increasing the flexibility with which states carry out their programs. Certain employment services designed to meet national needs would continue to be financed with grants under specific agreement with states."

No matter what else it implies, this signals some adjustment of the federal-state partnership. The extent to which states actually work with the administration on this issue will determine the eventual terms. How many states actually have articulated policy on the mission of their State Employment Security Agency and its interaction with other state policies? Clearly, a strong reevaluation of long term state strategy is a necessary precursor to dialogue.

Since UI is social technology that affects the behavior of millions, states will not miss the opportunity to use its incentive effects as a public policy tool.

Incentive effects of UI will become public policy

As one of the most massive income transfer programs ever conceived, Unemployment Insurance and its incentive effects have a strong influence on workers, employers and claimants. It is a social technology that affects the behavior of millions.

Many of these incentive effects have remained hidden from public view since the inception of the program. Others have received some publicity. Still other effects have yet to be developed.

Original federal legislation enabled states to form UI systems free from the fear that their state would suffer a competitive disadvantage among the states. Although they do not always call it by that name, many employers and claimants are aware of certain disincentive effects — for example, high weekly benefit amount compared to potential low earnings. Due to experience rating, lawmakers and employers are sensitized to the policy incentive available in noncharging. Uses can include promotion of new business, on-the-job training and more.

Several current ideas express possibilities that make use of various incentive effects that now exist or can be developed within the UI program. The development of new business is the source of most job creation. Several other nations have programs that allow UI beneficiaries to forego work search as they develop a business, withdraw their entitlement in a lump sum to finance their ventures or both. In all these countries workers contribute to the UI fund.

Another idea that has surfaced concerns the adequacy and incentive of the weekly benefit amount. One proposal suggests that claimants be loaned all or a portion of an amount they determine to be adequate to finance their search for work, with repayment due following reemployment. Under this scheme the interest due would be determined by a claimant experience rating, a mechanism to discourage repeated use of the system.

The Individual Training Account Act supposedly would piggyback the UI system in collecting amounts from employers who wish to participate. Their employees would contribute equal amounts and be able to draw for training or relocation assistance when they became unemployed. Although this bill is not feasible in its present form, it does represent an attempt to draw training assistance into the UI network.

Devolution foretells the possibility of greater variability among state UI programs. It is certain that some form of these ideas will be implemented, at least in pilot form, in the years to come.

Productivity: most efficient use of UI dollar is one that promotes efficient reemployment

Traditional government agencies have barriers to use of innovative techniques — weight of procedure, tradition, law and precedent (bureaucracy generates its own attitudes) and governmental policy decisions require due process and public input. This restricts responsiveness and speedy implementation.

Government has several strategies for overcoming these barriers. It also has definite motivation in the face of growing competition for tax dollars. A program of identification and use of efficient procedures depends to a large extent on worker feedback. Such feedback occurs only when actively nutured by management. Examples: Productivity Unit Program, Employee Suggestion Program.

Simplification and streamlining can be done through law, policy and procedure thus affecting program, processes and physical environment. Use of long term planning is necessary to adapt to future challenges. Pilot project to test and focus possibilities can provide the hard data necessary for evaluation and can provide background for public policy descisions. Use of statistical management information and performance standards provides guidelines for employer, individual and groups evaluation, and background for action toward agency goals.

The technological explosion has been a continuing effect on the way UI performs its business. What does all this mean? We, as agency directors and UI directors, must get out of the trenches, both at the state and federal levels, and assist our government and state legislature and the national office in developing policy that will: meet the needs of those who will need short time assistance because of technological change during economic downturns, strengthen the present system to provide employer relief when times are hard and provide income maintenance for those workers who are truly in need of it for a short period of time.

Because this is the year of the 50th anniversary of the UI system, we should make the commitment to improving the UI system to be the pacesetter example to all other programs, with the objectives to have well trained staff and good management, with the results being a saving of employer taxes and prompt and efficient service to claimants. Our federal partner can aid us most effectively in this effort if congressional action is enabling, rather than restrictive.

Future directions and changes in the UI System

by James A. Ware

The future is built on the history of the past and molded in the reality of the present. Unemployment Insurance is only 50 years olds, and its history in the United States represents a century of social change ranging from the first check of $15 in 1936 paid to Neils Rudd of Wisconsin to a check of $203 in 1984 payable to a New Jersey unemployed worker.

Lest we forget, the original objectives were:

Payment of unemployment benefits is an eligible worker's right — a personal benefit.

Provide a compulsory program for covered employers and workers.

Provide a social security and must always be examined in this context.

Allow employers to retain their skilled workforce during temporary shutdowns.

Reduce economic hardships on workers by temporarily replacing part of their pay with benefits.

Establish a labor exchange to assist the unemployed find work.

Lessen the cost of public welfare.

Help workers to maintain the saleability of their skills.

Provide stability for employers, workers and the community.

Based on the Federal Unemployment Tax Act's financing provisions (payroll tax) with a permissible state offset for approved Unemployment Compensation law.

Basically, the federal-state partnership is built on conformity of minimal standard for coverage, financing, qualifying, eligibility, disqualifications, and benefits.

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Wisconsin was the pioneer and led the way to enable this nation to recognize the plight of the unemployed worker. After the first 50 years, Unemployment Compensation is still on the books — still the law of the land — quite an achievement!

But in the checks that Neils Rudd of Wisconsin and the unemployed worker in New Jersey received are many differences. In one state the maximum and minimum weekly benefit amount was increased. At the same time the base period wages were raised to $252 in a quarter to qualify. Base period is 12 consecutive months preceding the start of a benefit year in which an unemployed worker has the required employment and/or wages to establish eligibility. Another state froze benefits at $136. Ten states are freezing benefits. In some of the other states the maximum benefit amount has been reduced to a lower percentage of the state's average weekly wage. One large industrial state reduced the wage replacement level of benefits from 50 percent to 48 percent for single claimants, from 60 percent to 55 percent for married claimants and from 66 2/3 percent to 62.4 percent for workers with dependent children.

UI requirements have changed drastically

States have been forced to take action to conserve their fund. One of the methods is to pay out less money to the unemployed. They have to be eligible to collect, and now they are ineligible and disqualified. The unemployed are helping to subsidize the unemployment fund by not collecting or collecting less benefits.

There is a difference between the Unemployment Insurance program of the 1930s and the 1980s. We have come a long way in paying out the dollar amount of benefits but are paying them to fewer eligible workers. Many states have tightened up on eligibility requirements, reduced benefits, frozen benefits, increased disqualifications, altered benefit formulas, expanded qualifying wages, changed suitable work definition and other revisions to reduce costs.

There are other frontiers waiting for pioneers. The federal government encouraged states to homestead the frontiers of work sharing and health care. But states are taking this period of economic prosperity to rebuild their low or depleted funds and repay their loans and interest. They have not enthusiastically followed the federal encouragement without additional federal funding.

Unemployment Insurance has been expanded only in solvent states to include work sharing provisions. Health care coverage, which had a priority during high national unemployment periods, has not been adopted by any state. Financing and solvency are the keys to a well functioning program.

The unemployment program of the 1990s will be changed radically especially in areas of financing, coverage, training provisions, eligibility and disqualifications and administration. My views of each of these areas is based on my experience and knowledge on the state and federal level, and my research for an upcoming book on the UI system.

In the 1990s, the problem of financing will be resolved by a universal federal tax on employees endorsed by both labor unions and employers. A percentage of the employee contributions will be targeted for the state's funds and the worker's retraining fund. The states will have to pass the required conformity legislation.

New sources of financing needed

The size of the budget deficit requires a new source of financing for Unemployment Insurance. We must be innovative and creative. Employee contributions of up to a

maximum of 1 percent will be the difference in solvency, the difference in federal matching revenues for training and retraining programs for unemployed claimants. Unemployment Insurance was and is a social security program based on attachment to the labor force. It is appropriate employers pay based on experience and all employees are assessed low premiums. We must have a capability to retrain our skilled work force. Workers must learn the skills of tomorrow and increase their productivity.

A worker is the nation's most important commodity. We must invest in our workers in order to help the fabric of the nation grow and prosper. We can't afford to have a country with an unemployment rate of 8 percent; with white youth at 20 percent and black youths at 50 percent. Hidden and discouraged unemployment could balloon the unemployment rate to 10-12 percent.

Unemployment in the economy is a tremendous cost. "A 1 percent rise in the rate of unemployment amounts to a $20 to $30 billion reduction in federal revenues," said Alice Rivlen, formerly director of The Congressional Budget Office. The same 1 percent rise in unemployment will cause a $3-4 billion expenditure. "The larger deficit resulting from the decreased revenue and increased expenses will cause the interest cost on the deficit to increase between $2-5 billion," stated Rivlen.

A 1983 "fact sheet" of the International Association of Personnel in Employment Security Legislative Committee, stated: "Using only the smaller numbers, a 1 percent increase in unemployment will cost the government in lost revenues and increased expenses about $26 billion. Since the unemployment rate last year was more than 2 percentage points lower than today, the cost to the government, and thus the citizens of the nation, is about $50 billion. The figure contributes significantly to the federal deficit." In 1985, this deficit is at an all time high and must be lowered. We cannot have millions of workers unemployed or not trained to learn new skills.

We are in the midst of a second industrial revolution. High technology, robots, computers, science, new skills, modern management systems, education, knowledge and learning as a team will characterized the work and industrial change. A sizeable investment must be made in our most important tool — our human capital.

Workers without jobs, but with an attachment to the workforce, must be retrained several times as new industries emerge and existing ones become obsolete. What this country needs is an industrial policy, not to finance employer expansion, but to concentrate on its most precious resource — the people.

We are a federal government

A part of any industrial policy is the strategy for Unemployment Insurance. W. Scott Boyd's "comments" in the *IAPES News* dated March, 1981, read:

"Every industrial nation in the world has a national manpower program and manpower delivery system. Such systems are necessary in highly industrialized nations and mandatory in an era of high labor mobility, changing industrial technology and shifting labor requirements.

"Ours is a complicated, highly technical industrial state. The simplistic view that each must care for his own is invalid and dangerous. It will lead to injustice, prejudice and inequity between individual workers and states.

"In the present instance the national welfare must be placed above and beyond the desires and ambitions of individual states. We are a federal government. Individual state interests must be subordinated to the national welfare and that of the citizens as a whole. How can we have a national manpower policy, or a national manpower system, if each

the 53 states go their separate ways, each with its own regulations, systems and philosophy?" (Editor's note: Puerto Rico, Virgin Islands, and the District of Columbia are treated as states by The Department of Labor.)

In the two largest states, California and New York, and in the smaller state of Delaware, legislation has been enacted for employment training panels by adding on an employer tax. Retraining has been recognized by these states in order to maintain their economic edge. Isn't it about time all states are given the same capability to assist their employers? We need an industrial policy. We need a comprehensive plan for industrial competitiveness.

A look at the next fifty years

In the 1990s, all workers will be covered for unemployment except self employed. Coverage will be liberalized due to employee contributions. In addition, temporary disability insurance benefits now payable in five states (New York, California, New Jersey, Hawaii and Puerto Rico) will be compulsory. The labor unions will increase their political and social power in the 1990s. They will foster an unemployment legislative package of health care for unemployed workers.

Eligibility and disqualifications will be lighter and shorter periods of earning required. Training will be mandatory after 10 weeks to receive benefits. Fines and penalties will become identical among the states. Extended benefits will be financed by the federal government with liberal payback requirement upon return to work.

New entrants to the labor market will be given UI federal benefits upon referral to a state vocational skills center by the Employment Service or service delivery areas under The Job Training Partnership Act. Skills centers will be established by law according to population, labor force, unemployment rate, etc. A regional advisory and a state advisory board will be named with representatives of Private Industry Council, vocational education, labor, public and state officials appointed by the governor.

The administration of the program will be highly computerized. In the 1990s, claimants will be identified by their thumb print. The workforce will be significantly reduced and capable of performing all functions. Employment Service and SDA personnel will be stationed in the local claims office for the work and training test, referral, testing, counseling, placement and other related functions. Computers will talk to computers from one state to another. Combined wage claims (CWC) and interstate benefits will be paid electronically on a daily basis.

Unemployment Insurance has been changed in its 50 years of existence. But let us remember it had its origin in France in 1896. The concept is almost 90 years old! Every industrial country has an employment program. For example, more than 60 nations have a family or children's allowance program. In most industrial countries, workers and their families are covered by medical insurance or health service provided through public programs. These are but a few of the progressive steps taken in Unemployment Insurance by industrial nations.

Fifty years of quality UI service was provided by the employees of the Unemployment Insurance service. It was an exciting time, a time of challenges, a time of miracles, and through it all the basic program came through with flying colors and its basic premises remain in tact. Congratulations and get ready for the next 50 — what is past is prologue.

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